



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

August 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**

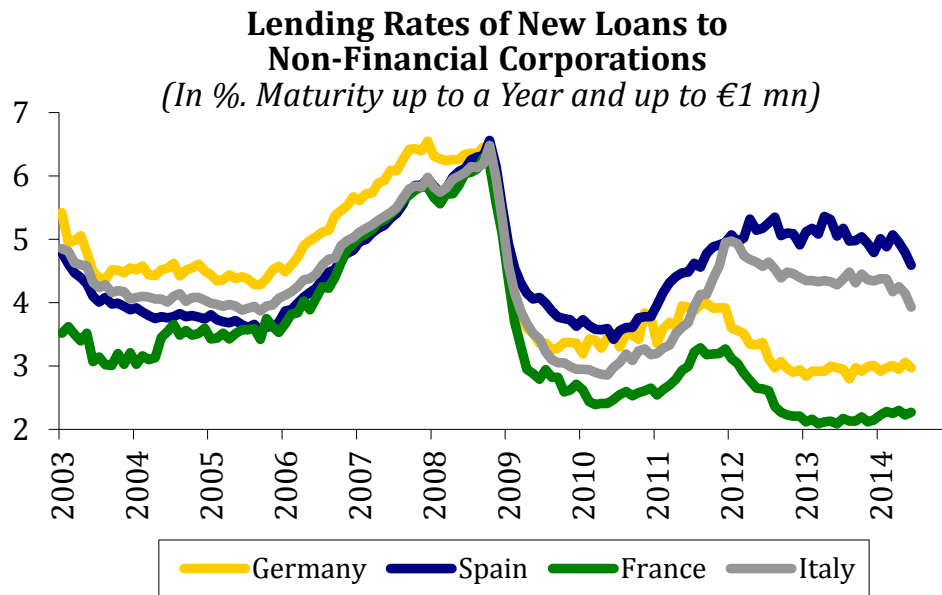
## **2. Spanish Economic Policy**

## **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

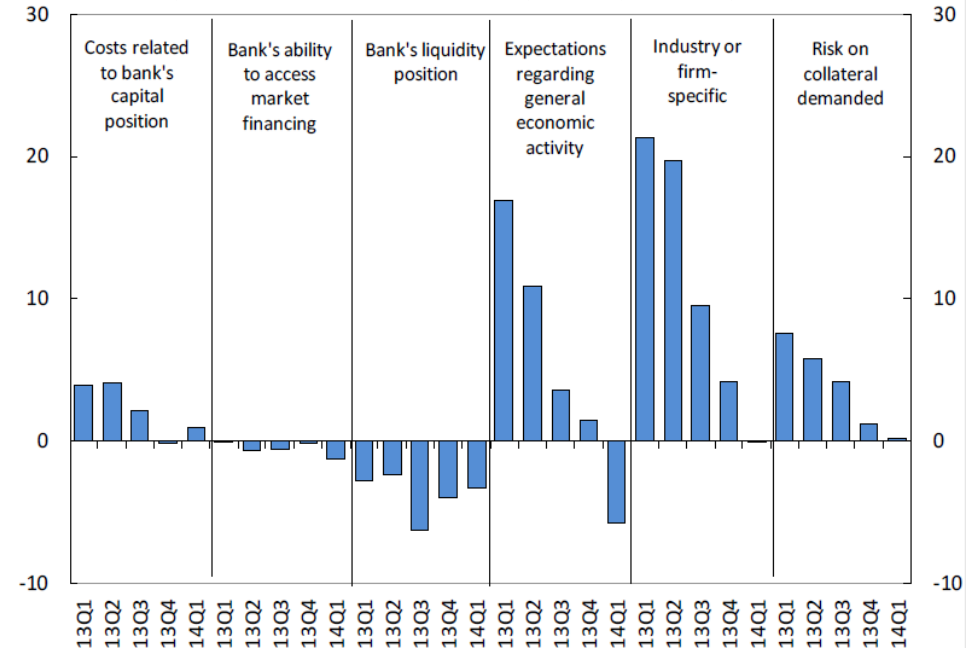


Source: European Central Bank.

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)*	-0.4	1.1	1.5	1.9	1.7	3.0	1.7	3.2	2.7
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

\* World Economic Outlook (WEO) Update, July 2014

Data

Rest of data: World Economic Outlook (WEO)

## 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

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# 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

Budgetary Plan 2013-2014

Financial Sector Reform

Services/Product Markets

Pension System Reform

Strategic Plan for Exporters

Serv. Market Liberalisation

Local Administrations

ICO Mediation Credit Lines

Single Market Law

De-indexation

## 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

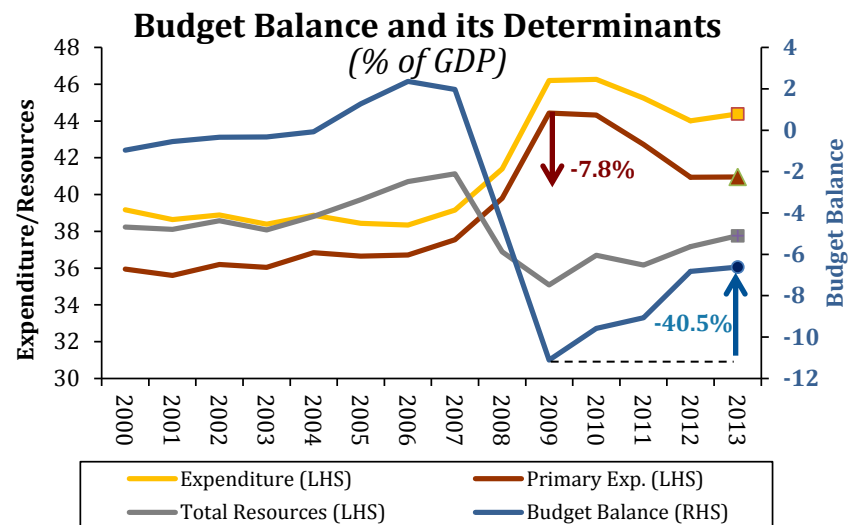
Links to detailed presentations describing the Reform Agenda

*[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.

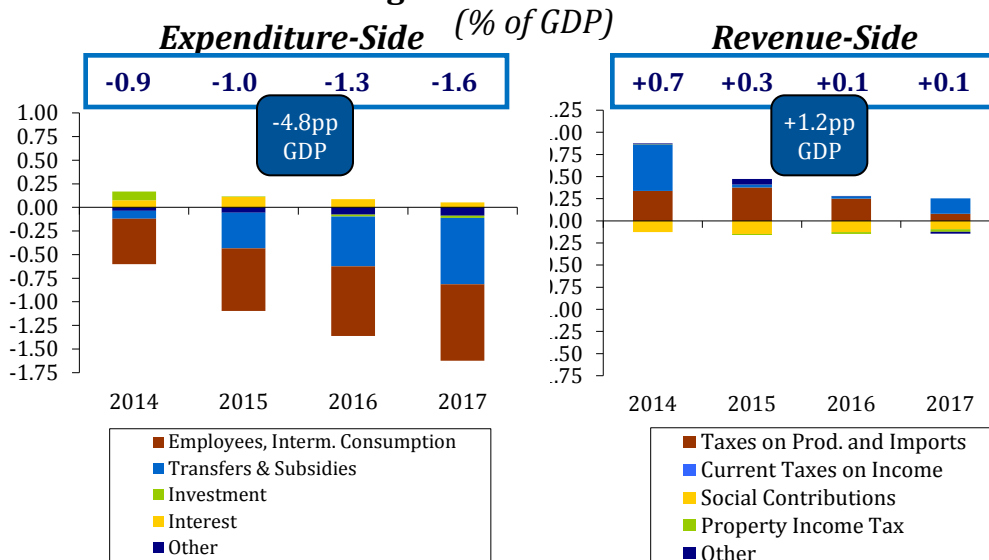
Data

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
<b>General Government</b>	<b>-6.62</b>	<b>-5.5</b>	<b>-4.2</b>	<b>-2.8</b>	<b>-1.1</b>
<b>Primary Balance</b>	<b>-3.20</b>	<b>-2.0</b>	<b>-0.6</b>	<b>0.9</b>	<b>2.7</b>
<b>Structural Balance</b>	<b>-2.0</b>	<b>-1.3</b>	<b>-1.0</b>	<b>-0.5</b>	<b>0.1</b>
<b>Structural Primary Balance</b>	<b>1.4</b>	<b>2.2</b>	<b>2.6</b>	<b>3.2</b>	<b>3.8</b>
<b>Nominal Adjustment</b>	<b>0.2</b>	<b>1.1</b>	<b>1.3</b>	<b>1.4</b>	<b>1.7</b>
<b>Financial Sector one-offs</b>	<b>0.5</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>

Source: Ministerio de Economía y Competitividad.

Data

## Changes to the fiscal balance



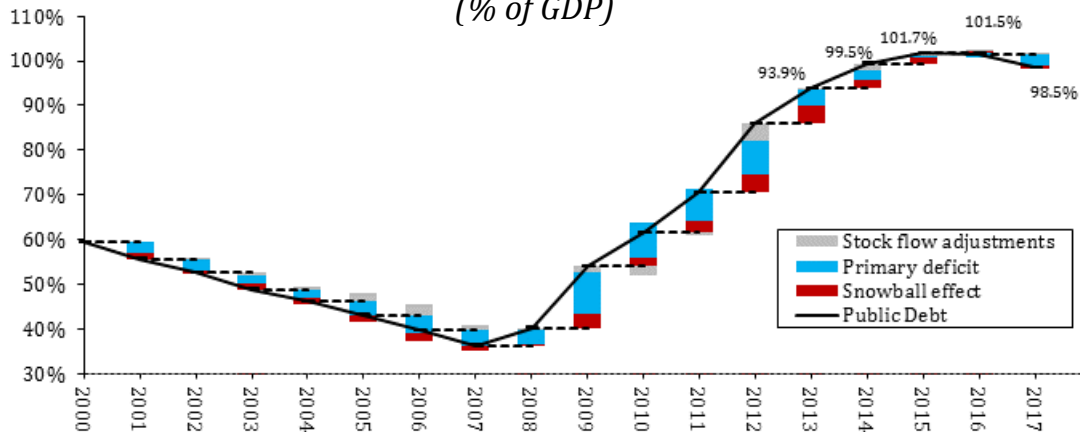
Source: Ministerio de Economía y Competitividad.

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

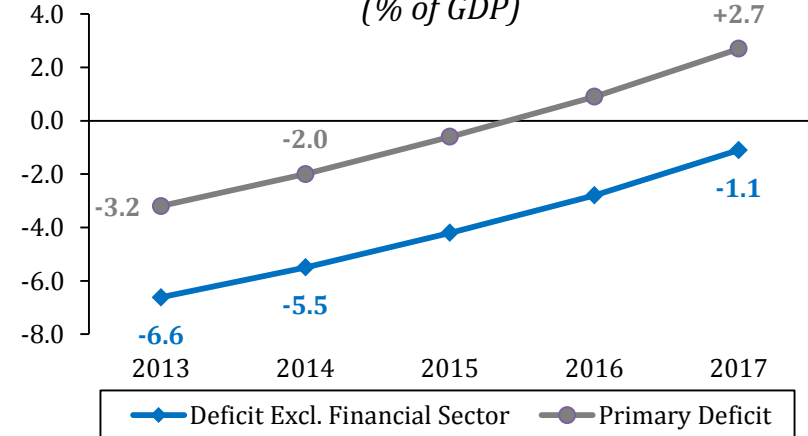
Forecast of General Government Debt (% of GDP)



Source: Ministerio de Economía y Competitividad.

[Data](#)

Deficit and Primary Deficit (% of GDP)



Source: Ministerio de Economía y Competitividad.

[Data](#)

# Budgetary execution in 2014

## ▶ Monthly budgetary execution data for the most relevant administrations released in National Accounting terms since April 2013

☐ Central Government (May 2014 data): the combined deficit of the Central Government Administration and the autonomous entities of the Central Govt. reached €23.6 bn

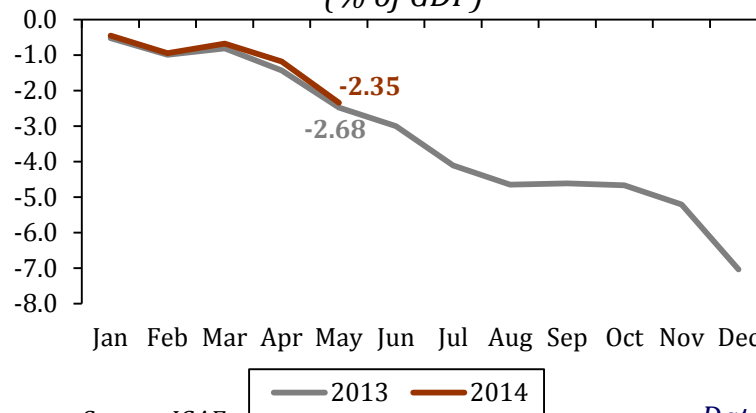
▪ Central Gov. Administration (June 2014 data): deficit €26.2 bn vs €32.4 bn in June 2013

- ✓ Income increased by 6.9% y-o-y
- ✓ Expenditure decreased by 2.7% y-o-y

☐ Regional Governments (May 2014 data): deficit reached €6.2 bn

☐ Social Security Administrations (May 2014 data): the Social Security posted a surplus of €5.4 bn

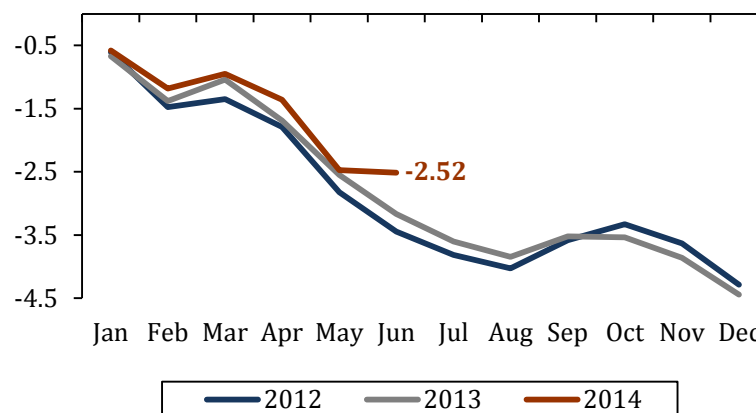
**Combined Deficit of Central & Regional Governments and Social Security Administrations. Excl. Financial Sector Recapitalisation (% of GDP)**



Source: IGAE.

[Data](#)

**Breakdown of the Budget Balance of the Central Government Administration 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

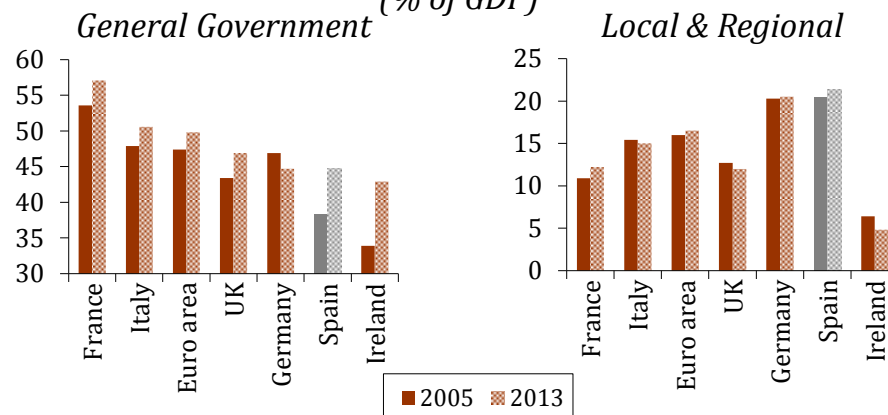
► The Law for the Reform of the Public Administrations targets gains in efficiency and the professionalisation of political and administrative functions at all levels of government

► 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

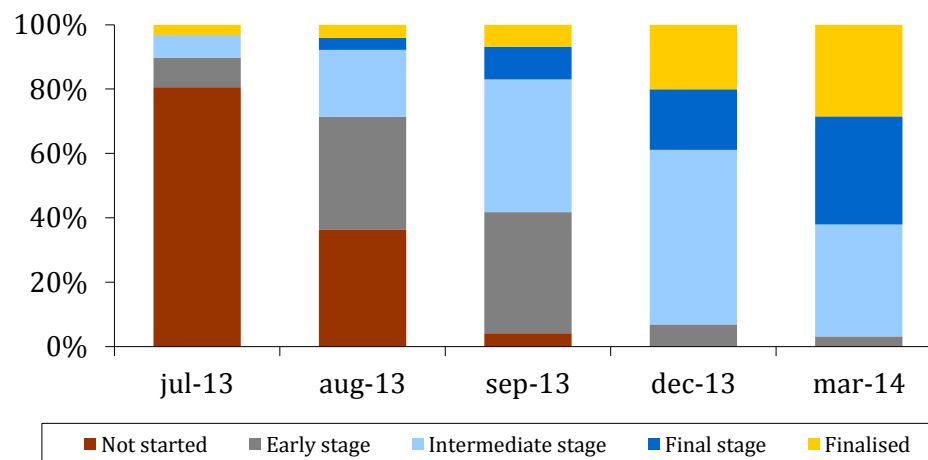
**Expenditure Excluding Financial Sector One-Offs**  
(% of GDP)



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 20<sup>th</sup> and its referral to Parliament is expected in July
- ▶ Aims at reducing taxation on labour, 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

Changes to Personal Income Tax	Changes to Tax on Capital	Changes to Corporate Income Tax	VAT	Fight Against Tax Fraud	R&D and cultural investment
<ul style="list-style-type: none"> <li>▶ Reduction in number of tranches and rates in two years</li> </ul>	<ul style="list-style-type: none"> <li>▶ Lower rates in two years and more progressive</li> </ul>	<ul style="list-style-type: none"> <li>▶ Reduced general rate: from 30% to 25% in two years (reduced rate for new firms 15%)</li> </ul>	<ul style="list-style-type: none"> <li>▶ Health care products</li> <li>VAT rate adapted to ECC regulations:</li> <li>- Intermediate products for drug development, medical instruments and equipment, medical devices and pharmaceutical products</li> </ul>	<ul style="list-style-type: none"> <li>▶ Lists of defaulters to be published</li> </ul>	<ul style="list-style-type: none"> <li>▶ 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</li> </ul>
<ul style="list-style-type: none"> <li>▶ Modification of personal income allowance:                             <ul style="list-style-type: none"> <li>- Higher personal income minima</li> <li>- Family tax deductions: enabling negative tax rates for large families and with dependent persons with serious disabilities</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>▶ Elimination of tax deduction for dividends</li> <li>▶ Capital gains generated in less than 12 months no longer penalised</li> </ul>	<ul style="list-style-type: none"> <li>▶ In the case of the financial sector kept at 30%</li> <li>▶ Substitution of deductions in CIT                             <ul style="list-style-type: none"> <li>● Deductions eliminated:                                     <ul style="list-style-type: none"> <li>- Environmental investments</li> <li>- Expenses for vocational training</li> <li>- Reinvestment of extraordinary benefits</li> </ul> </li> <li>● New deductions (favouring the deleveraging process):                                     <ul style="list-style-type: none"> <li>- Capitalisation reserves. 10% of corporate income deductible if incorporated into reserves.</li> <li>- Equalisation reserve for SMEs</li> </ul> </li> <li>● Limits to the financial expenditure deductions (favouring the deleveraging process, reduced to 30% of gross operating profit)</li> </ul> </li> </ul>		<ul style="list-style-type: none"> <li>▶ Annual publication of tax havens</li> <li>Tax audit process: New deadlines and suspension of Statutes of Limitation in specific situations</li> </ul>	
<ul style="list-style-type: none"> <li>▶ Limits to exemptions to severance payments in case of unjustified dismissal</li> </ul>	<ul style="list-style-type: none"> <li>▶ New savings instrument: savings or insurance schemes maintained longer than five years ('Cuenta Ahorro 5'): exempt from capital gains tax</li> </ul>	<ul style="list-style-type: none"> <li>▶ Update and simplification of depreciation tables</li> </ul>	<ul style="list-style-type: none"> <li>▶ New rules on the localisation of assets; taxing at destination of electronic, telecommunications and radio-television services when the addressee is a private individual</li> </ul>	<ul style="list-style-type: none"> <li>▶ Administrative assessment in evidence of tax fraud</li> </ul>	<ul style="list-style-type: none"> <li>▶ Companies investing more than 10% of their accounting net income in R&amp;D will extend their percentage of deduction to 50%.</li> </ul>
<ul style="list-style-type: none"> <li>▶ Tax deductions for house rental:                             <ul style="list-style-type: none"> <li>- Elimination for new rentals (Expenditure side)</li> <li>- Lower tax deductions for house rentals (Income side)</li> </ul> </li> </ul>				<ul style="list-style-type: none"> <li>▶ Limit for deductible contributions linked to pension plans lowered to €8,000/year</li> </ul>	
<ul style="list-style-type: none"> <li>▶ Lower tax withholding for professional and self-employed workers with incomes below €15,000</li> </ul>	<ul style="list-style-type: none"> <li>▶ Better fiscal treatment in case of assets received in lieu of payment if affected by preference shares</li> </ul>	<ul style="list-style-type: none"> <li>▶ General limit 60% for Tax loss carryforwards as from 2016</li> <li>▶ To maintain income from the CIT, in 2015 previous measures maintained</li> </ul>	<ul style="list-style-type: none"> <li>▶ Imprescriptibility of the Administration's right to check tax credits derived from statute-barred tax years</li> <li>▶ Interruption of the limitation period of related tax obligations</li> </ul>	<ul style="list-style-type: none"> <li>▶ Better precision in the indirect assessment regime</li> </ul>	<ul style="list-style-type: none"> <li>▶ Incentives for cultural activities</li> </ul>
<ul style="list-style-type: none"> <li>▶ Limits to simplified method ('Modulos') to certain professional activities</li> <li>▶ Elimination of abatement coefficients and monetary correction gains</li> </ul>					

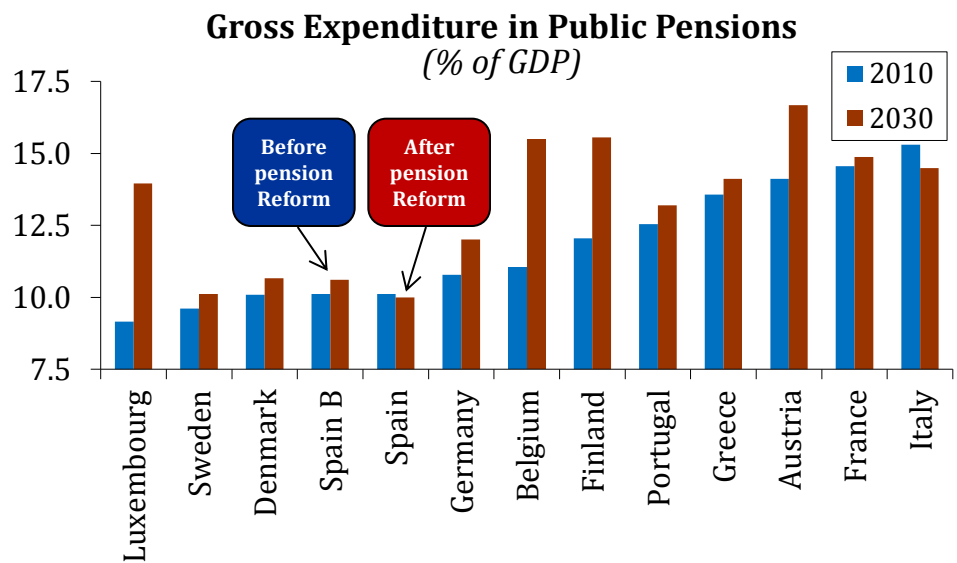
# The Pension System reform reduces the impact of population ageing

► 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



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	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>→ Lack of flexibility avoided innovation and gains in competitiveness</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>			



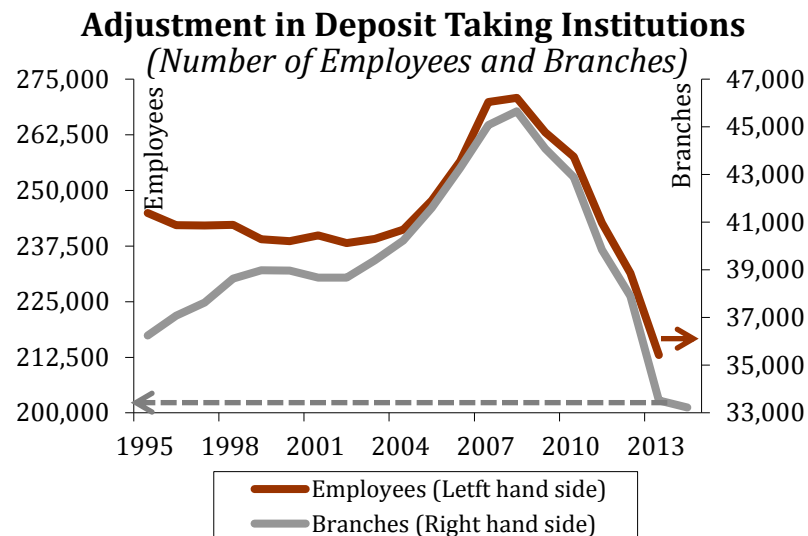
## Activation policies & fight against unemployment

► 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

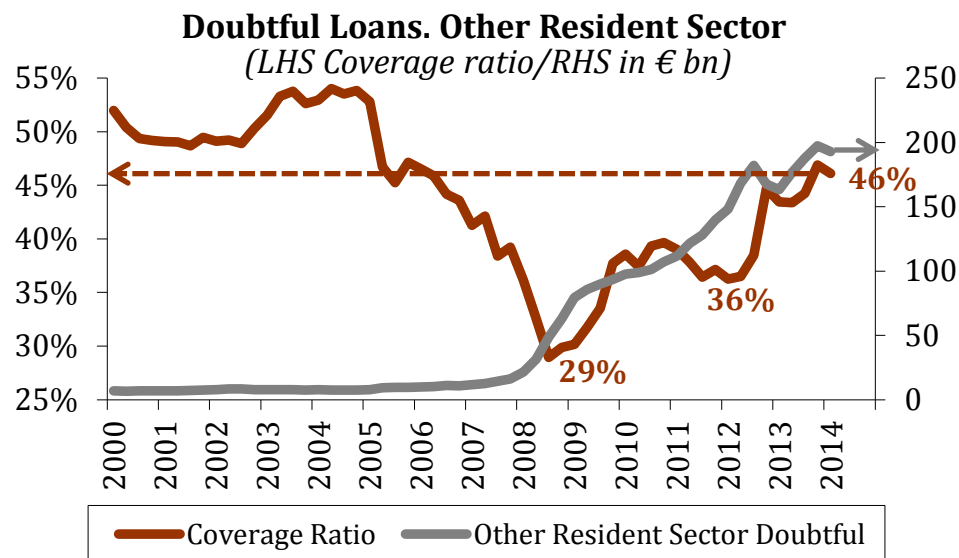
# Adjustment and recapitalisation of the financial system (I)

- ▶ 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



Source: Bank of Spain.

[Data](#)

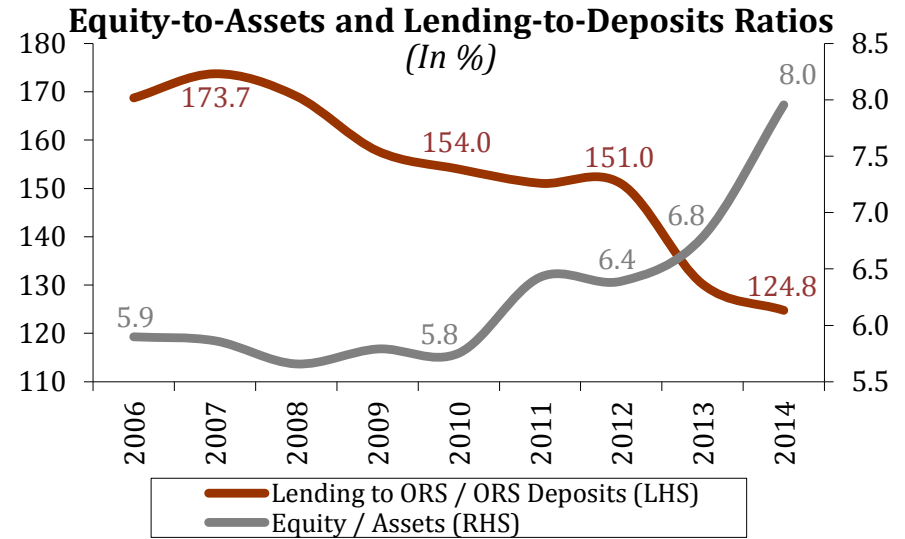


Source: Bank of Spain.

[Data](#)

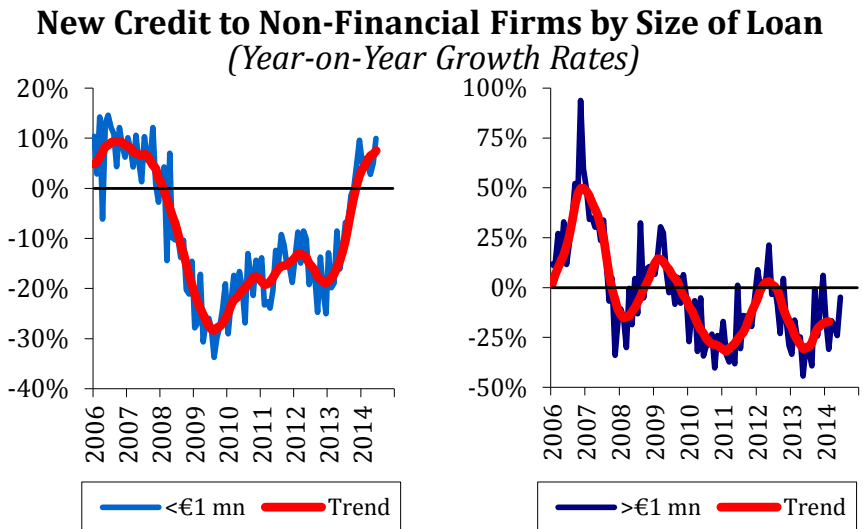
## Adjustment and recapitalisation of the financial system (II)

- ▶ Capitalisation of the financial sector: equity-to-asset ratio of the overall sector has increased from 5.8 in 2010 to 8.0 up to May 2014
- ▶ The lending-to-deposits ratio has declined from 154% to 124.8%, 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



Source: Bank of Spain.

Data



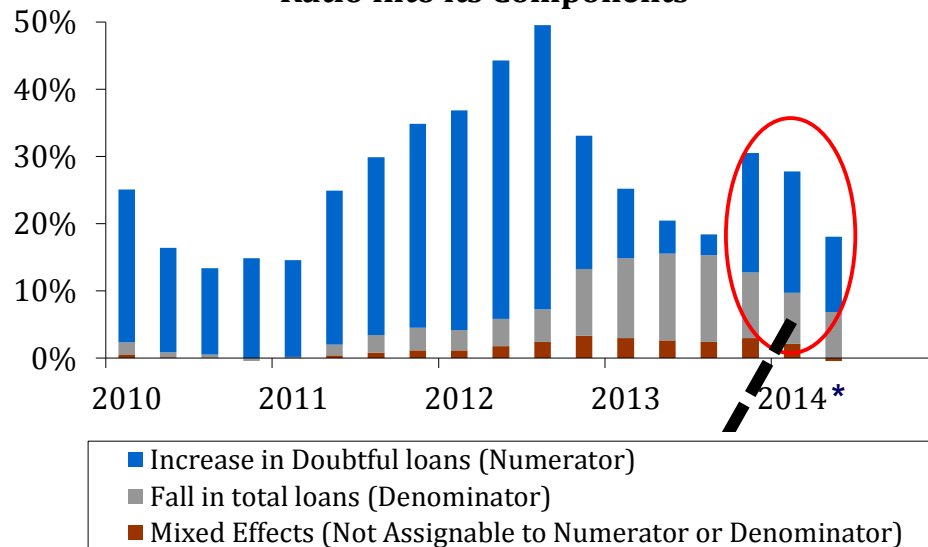
Source: Bank of Spain.

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

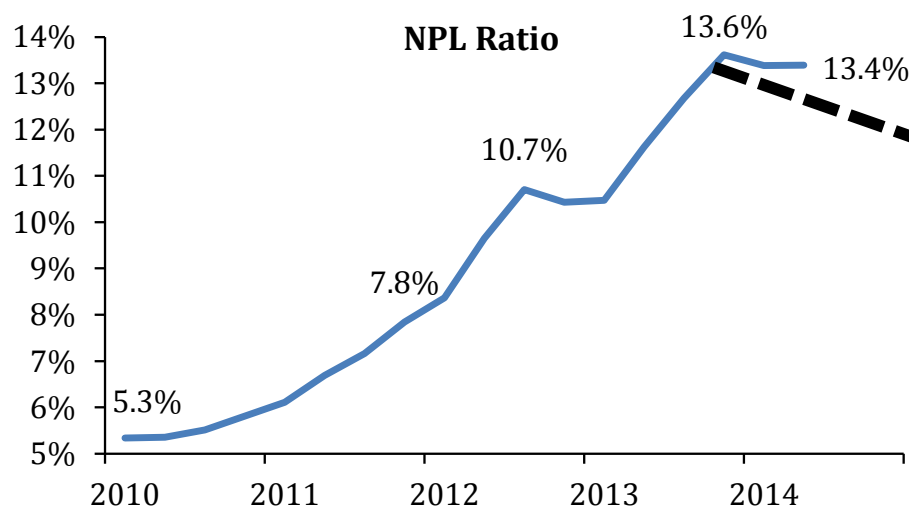
Breakdown of Year-on-Year Growth Rate of NPL Ratio into its Components



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 amounting to €50,781 mn, valued at transfer prices

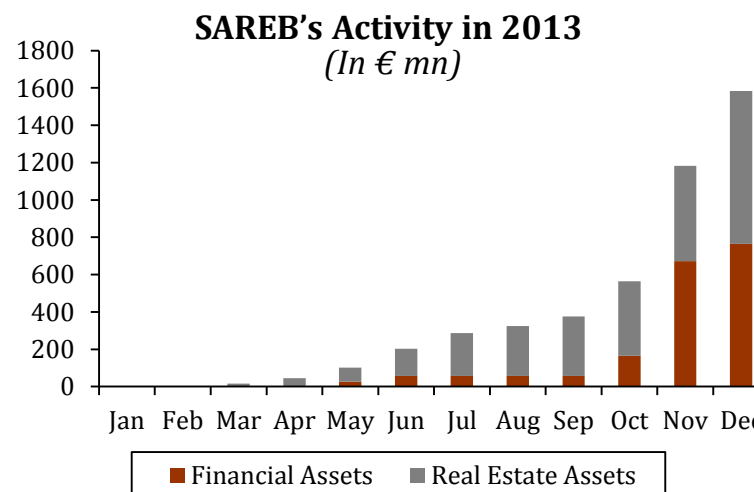
- ❑ €34.438 mn financial assets (loans to real estate promotion)
- ❑ €11.343 mn real estate assets

► These assets were transferred 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](http://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

SMEs banking credit

Mutual guarantee funds reform

Financial credit establishments at sales point

Revision of the securitisation regime

Access to capital markets

Crowdfunding Regulation

### Royal Decree on Debt Restructuring: removal of obstacles to agreements between debtors and creditors

Individual Refinancing Agreements

Simplification of Collective Refinancing Agreements

#### COMMON MEASURES

- Extension of agreements to dissenting creditors
- Interruption of enforcement measures up to conclusion of arrangements
- Fresh money as claim against the estate

### Improvement of venture capital funds' regime

More flexible investment regime for venture capital funds

New type of SMEs venture capital funds with an even more flexible investment regime to fuel equity and debt financing to SMEs

Reduction of administrative burdens for venture capital funds

Compliance with AIFM Directive

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 <i>(In p.p.)</i>	2012	2013	2014	Cumulative 2012-2014 <i>(In p.p.)</i>
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.

**1. Closer EMU Integration**

**2. Spanish Economic Policy**

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

**4. The Funding Programme of the Spanish Treasury**



## 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

- 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 further
- Lower growth needed for employment creation in the private sector
- Re-composition of the asset/liability structure of firms' balance sheets
- Households' and Non-financial firms' debt has adjusted

## 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

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Macroeconomic scenario (Year-on-year growth rates in percent)	2013	2014		2015(f)	2014(f)		
		Full year forecast	2014-Q1		European Commission (Spring Forecast)	OECD (May 2014)	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
<b>National Demand*</b>	<b>-2.7</b>	<b>0.7</b>	<b>0.7</b>	<b>1.2</b>	<b>0.4</b>	<b>-0.1</b>	<b>0.5</b>
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	--
<b>External demand*</b>	<b>1.5</b>	<b>0.6</b>	<b>-0.2</b>	<b>0.5</b>	<b>0.8</b>	<b>1.1</b>	<b>0.4</b>
<b>Gross Domestic Product</b>	<b>-1.2</b>	<b>1.2</b>	<b>0.5</b>	<b>1.8</b>	<b>1.1</b>	<b>1.0</b>	<b>0.9</b>
<b>Other macroeconomic variables</b>							
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.*

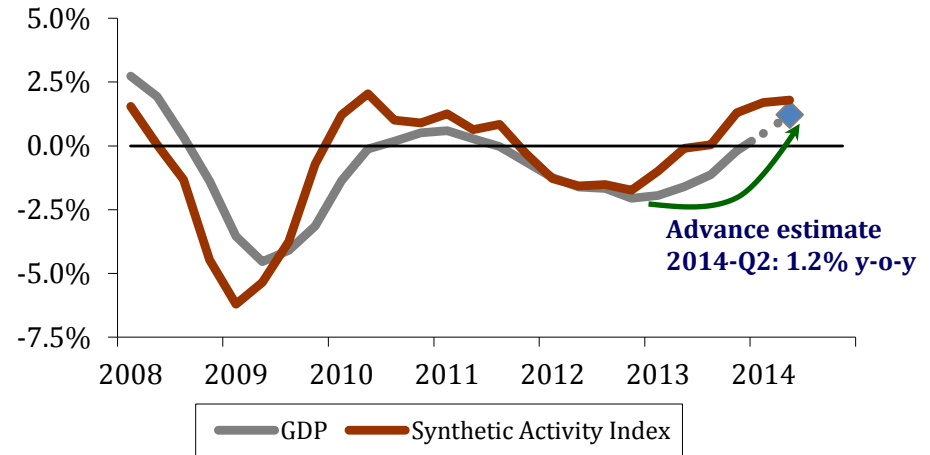
\* Contributions to GDP in p.p. \*\* Data for Central Government, Regions and Social Security

# 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

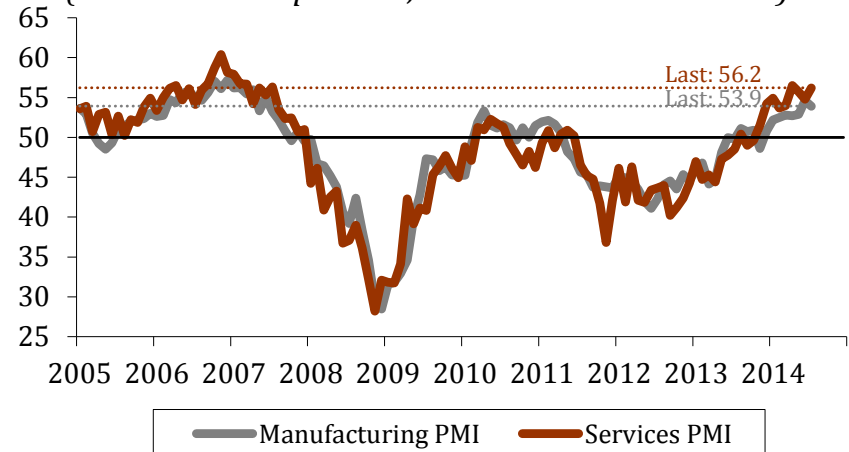
- ❑ Coincident and leading indicators point towards a change of cycle, especially in the services sector
- ❑ Synthetic Activity Indices (composite indices designed to gauge overall economic activity): forward-looking signs of improving activity
- ❑ The rebalancing towards tradable goods and services 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

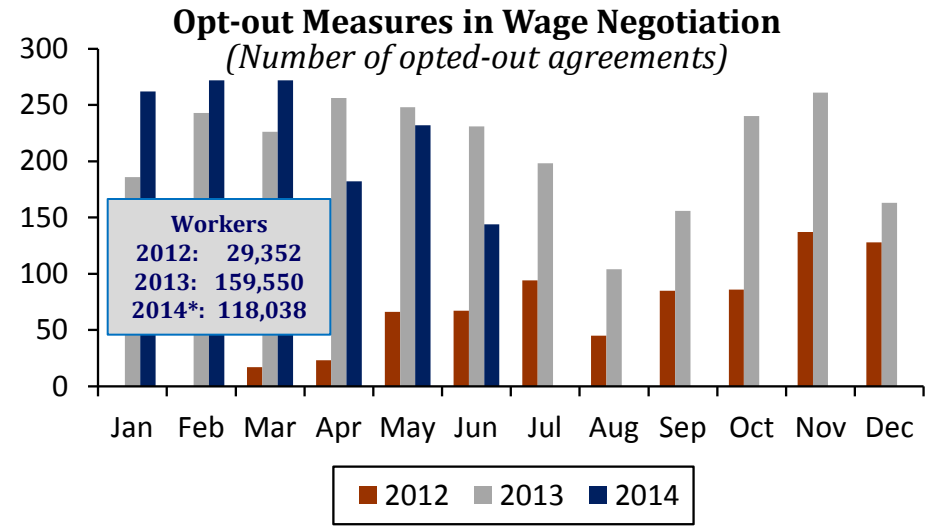
► The reform has eased opting out from collective agreements; most linked to wage negotiation (approx. 90% of all opting-outs clauses in 2013)

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

► Acceleration of self-employment and private employees, contraction of public employees

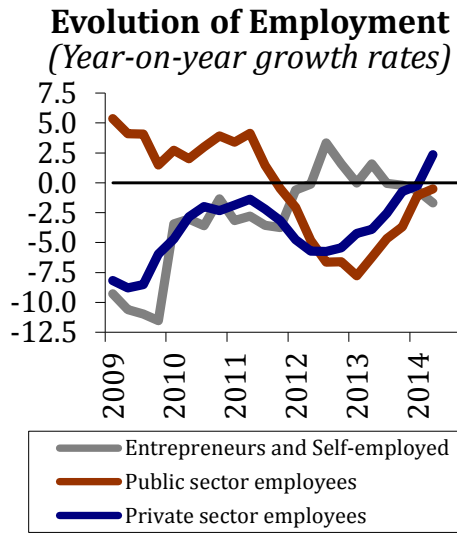
☐ Since 2011 the number of employees in the public sector has diminished substantially, reaching 2007 levels: a reduction by 377,100 employees since 2011-Q3

☐ Private sector employees are since end-2013

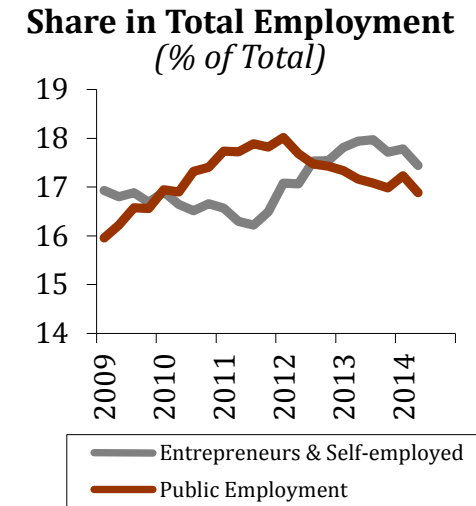


Source: Ministerio de Empleo y Seguridad Social.  
\* 2014: from July 2013 to June 2014

Data



Source: National Statistics Institute.



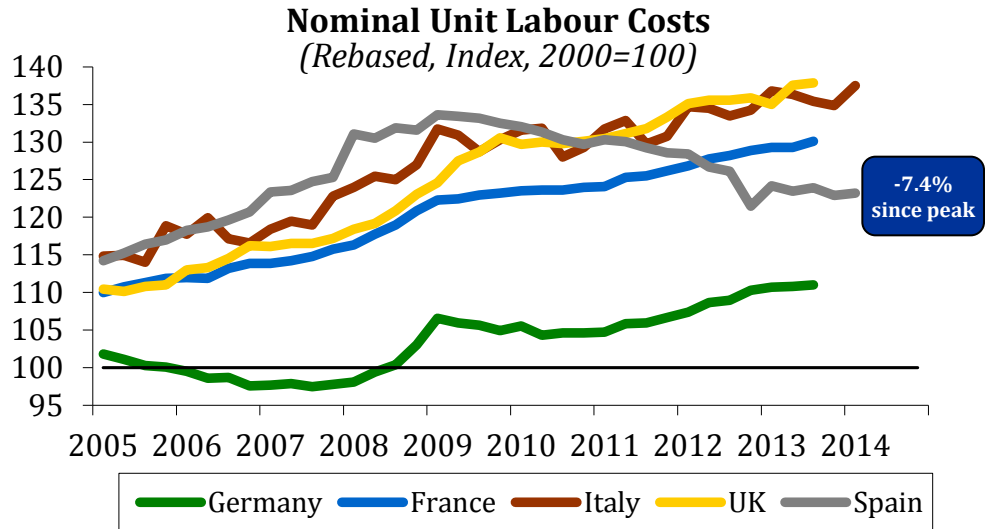
Data

# 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:

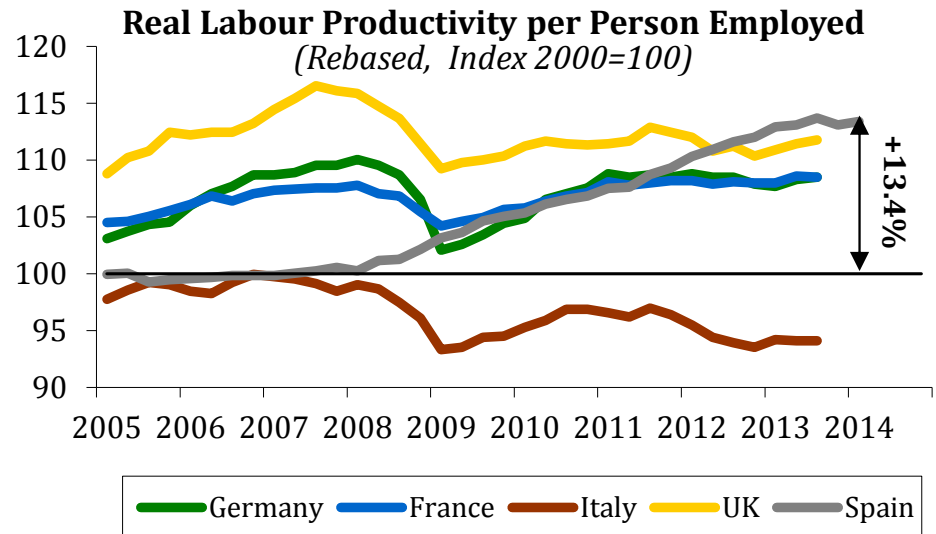
☐ Nominal unit labour costs have declined by 7.4% since the peak in 2009 and are at similar levels than in 2007-Q1

☐ 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

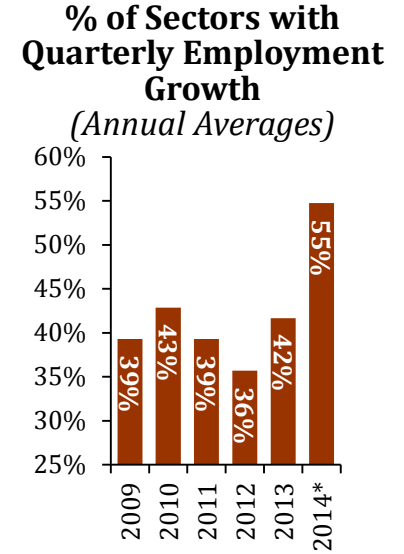
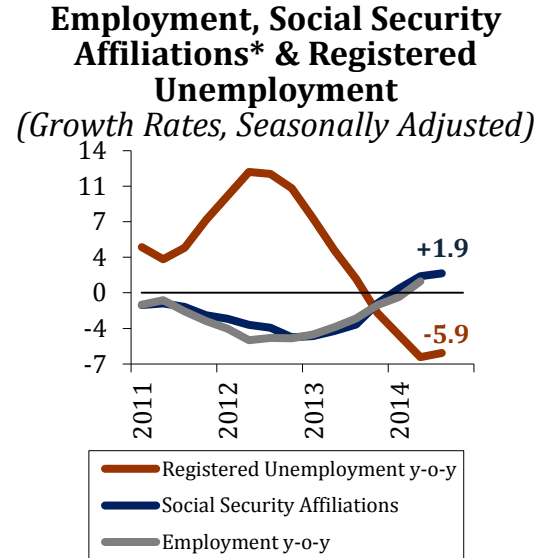


Source: Eurostat.

Data

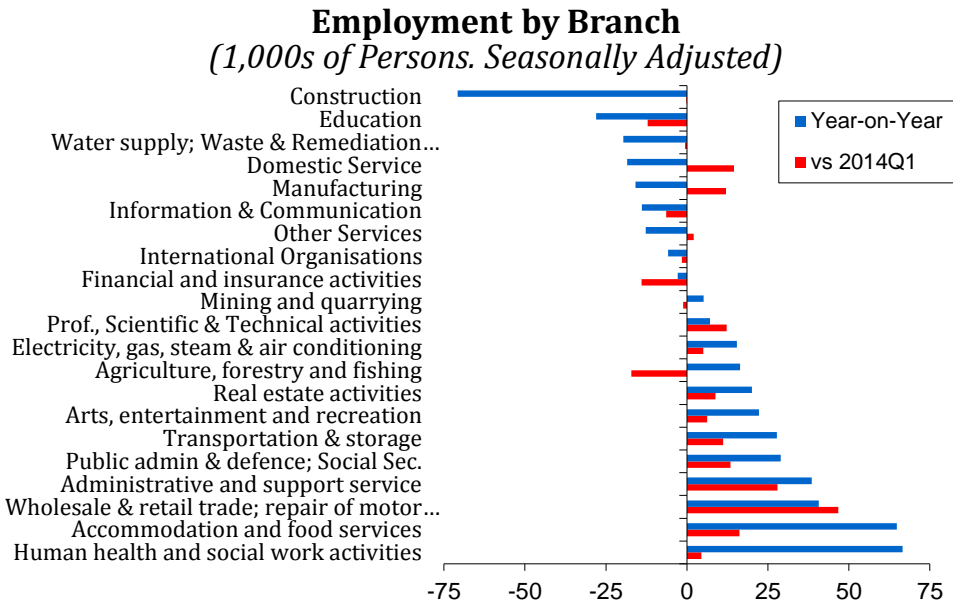
# Lower growth needed for employment creation in the private sector

- ▶ New regulatory framework has decreased the minimum GDP growth required for net private sector job creation
- ▶ Increased employment and more broad-based: 55% of branches, social security affiliations +1.9% y-o-y



Source: National Statistics Institute. [Data](#)

[Data](#)

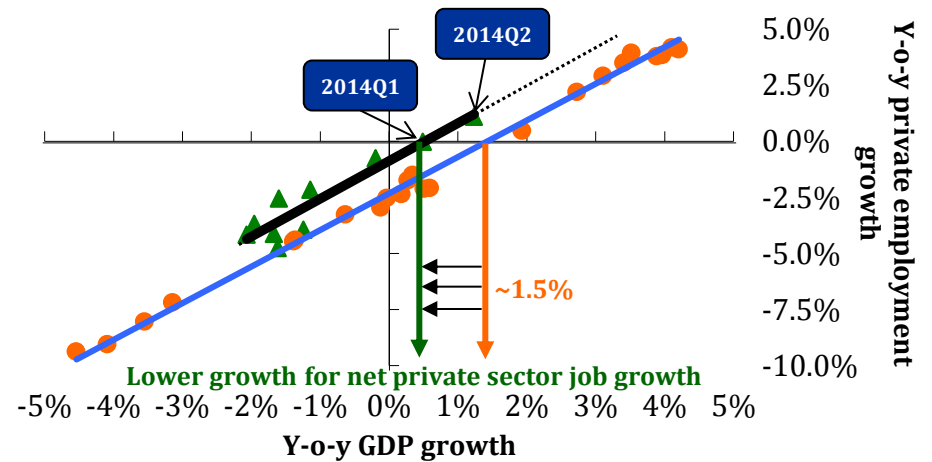


Source: National Statistics Institute.

[Data](#)

### Growth Required for Private Employment Creation

(Quarterly Data, Seasonally and Calendar Adjusted)

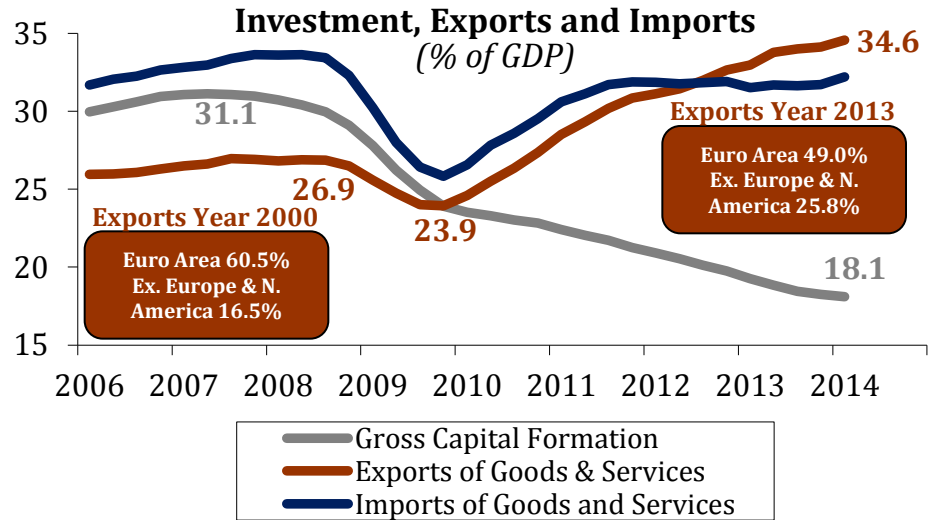


Source: National Statistics Institute.

[Data](#)

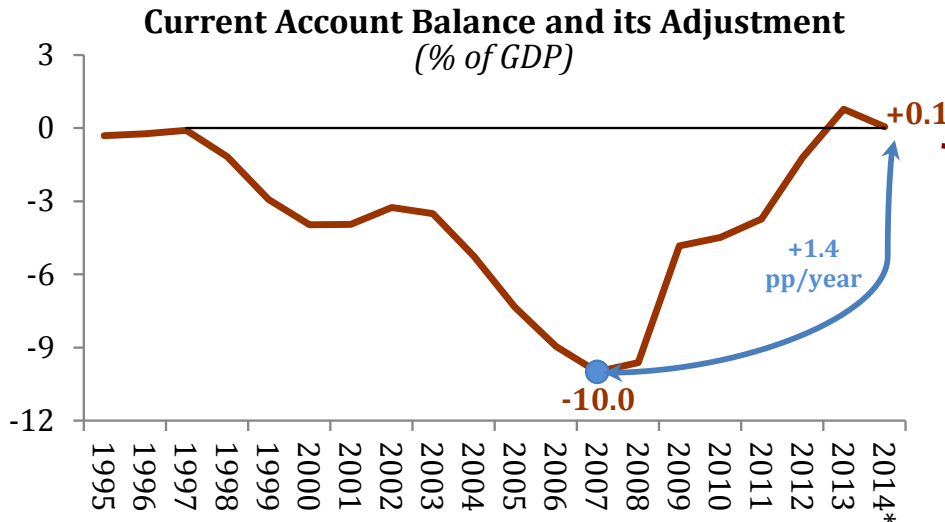
# Rapid expansion of the external sector

- ▶ 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 June 2013 to May 2014: 0.3% of GDP
- ▶ Internal devaluation process more effective in CA correction than nominal devaluations



Source: National Statistics Institute.

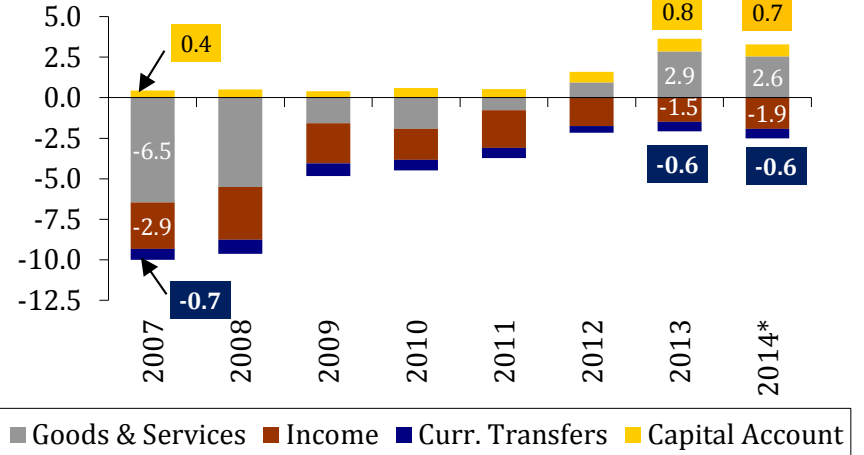
Data



Source: Bank of Spain.  
\* Up to May 2014

Data

## Current Account Balance and Capital Account Balance (% of GDP)



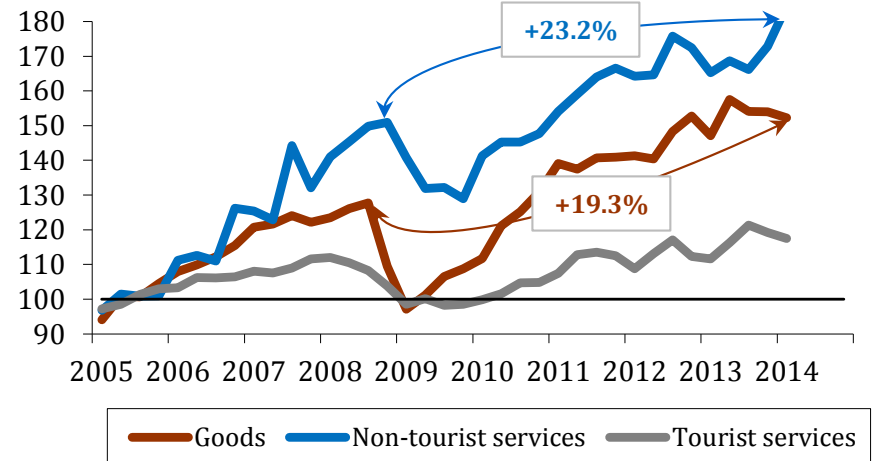
Source: Bank of Spain.  
\* Up to May 2014

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

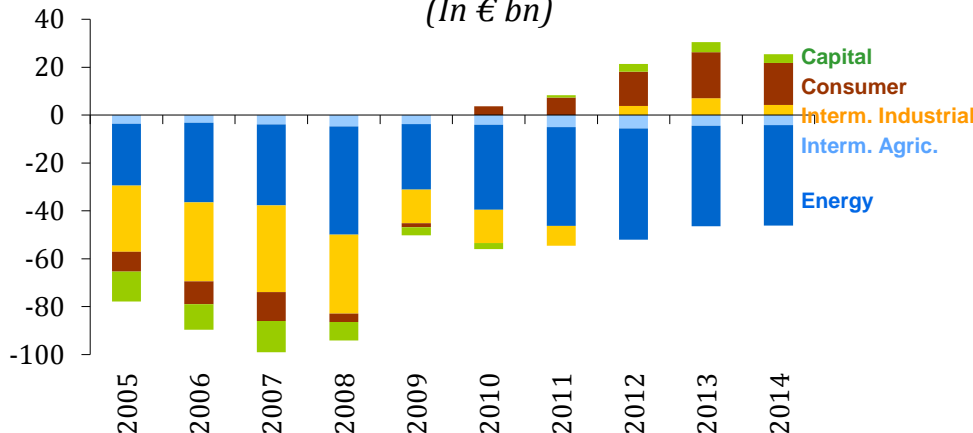
**Nominal Exports of Goods and Services**  
(Index, 2005=100)



Source: National Statistics Institute.

[Data](#)

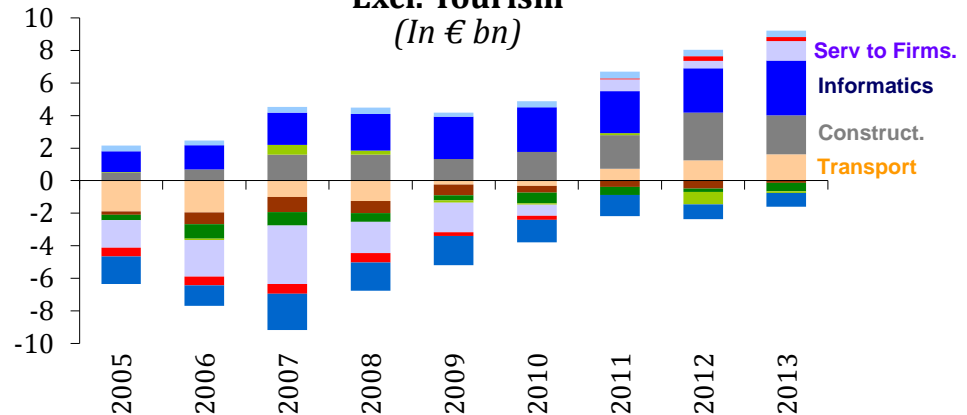
**Net Exports of Goods**  
By Type of Good  
(In € bn)



Source: Bank of Spain.

[Data](#)

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



Source: Bank of Spain.

[Data](#)

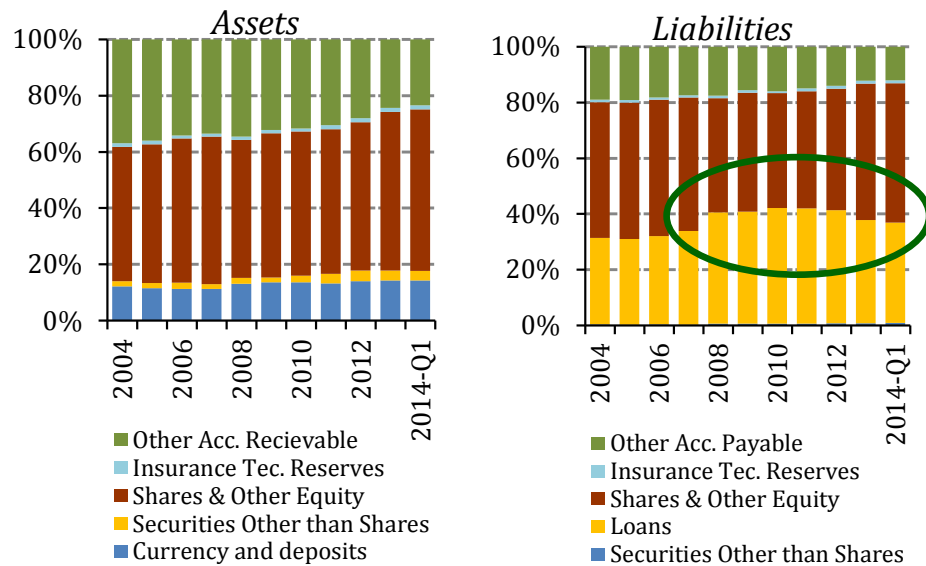


# Deleveraging of the private sector: re-composition of assets and liabilities

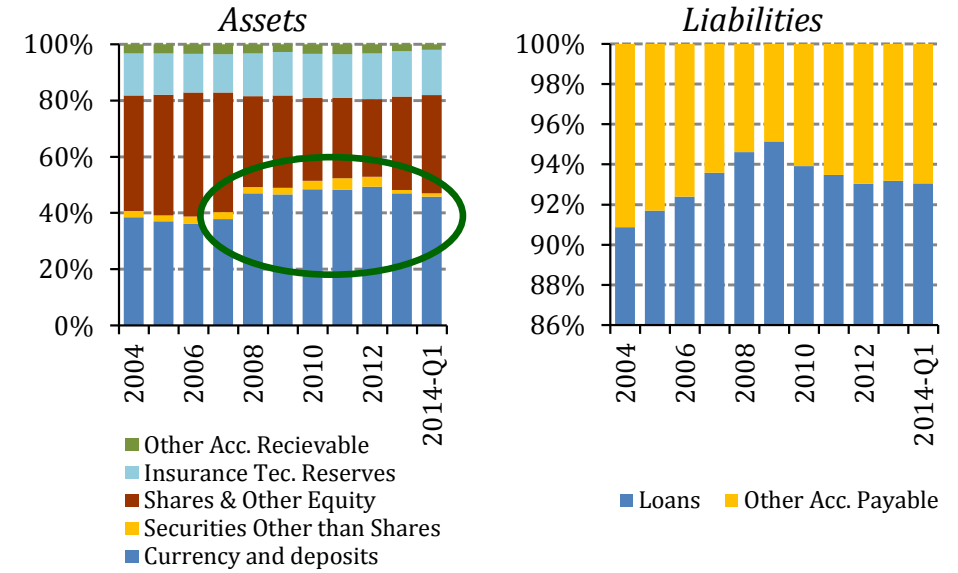
► The private sector is gradually switching from traditional debt to equity, in both, assets and liabilities

- ❑ Non financial corporations: liabilities less intensive in loans and commercial credit, more holdings of equity vs. currency and deposits
- ❑ Households holdings of equity have improved household wealth through stock market growth

**Non-Financial Corporations**  
(In % of Total Financial Assets/Liabilities)



**Households**  
(In % of Total Financial Assets/Liabilities)



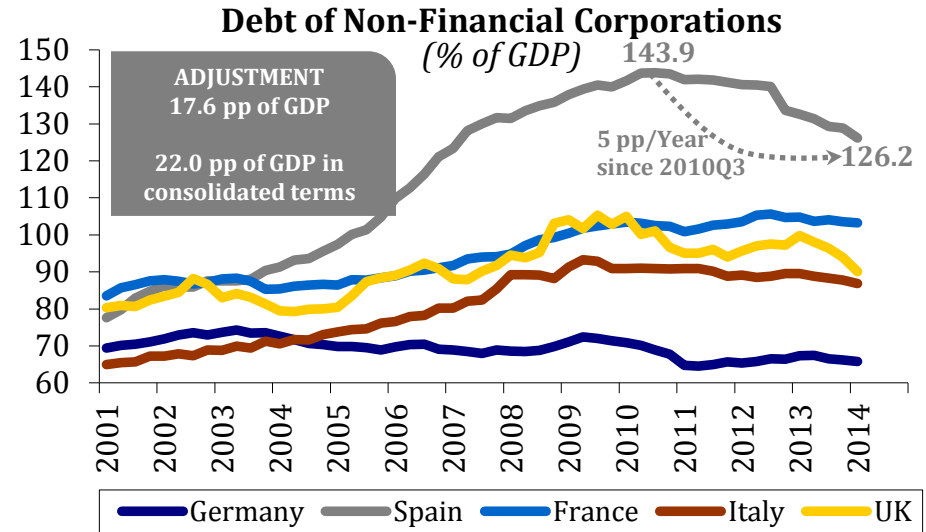
Source: Bank of Spain.

Data

# Deleveraging of the private sector: non-financial corporations

► Non-financial firms reduced their debt stock by c.18% of GDP. Firms generating savings and concentrated on reducing debt

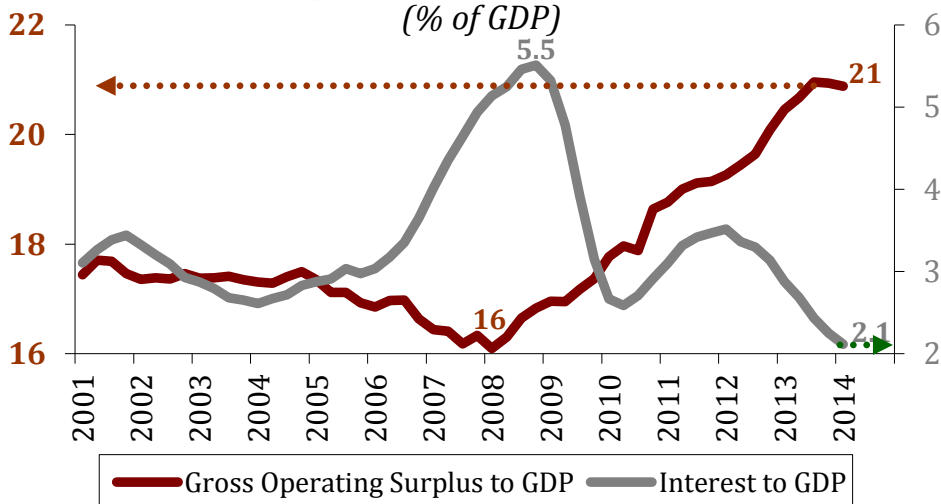
- Gross operating surplus of non-financial corporations has increased from below 16% of GDP to above 21% in 5 years
- Strong flow correction: indebtedness excl. equity to Gross Operating Surplus and to Gross Disposable income around 2004 levels



Source: ECB.

[Data](#)

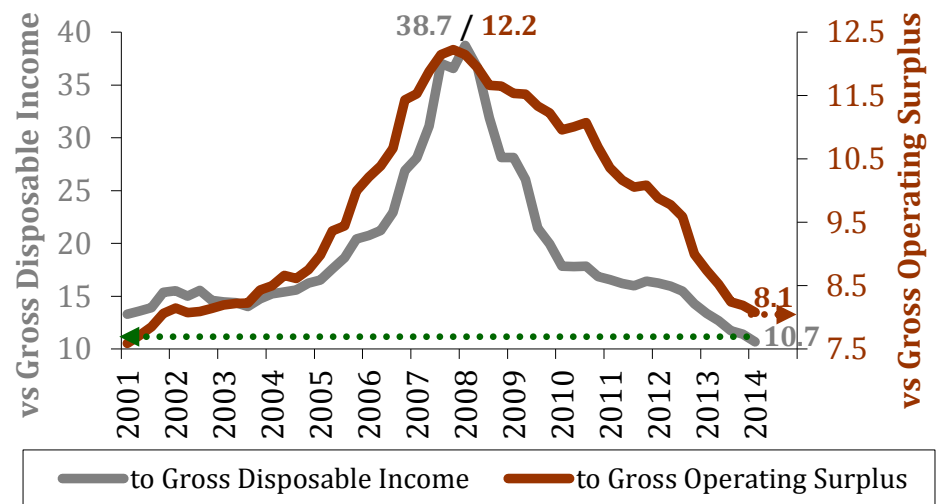
Gross Operating Surplus of Non-Financial Corporates and Interest Paid (% of GDP)



Source: National Statistics Institute.

[Data](#)

Non-Financial Corporations. Liabilities Excl. Equity to Gross Disposable Income and Gross Operating Surplus



Source: National Statistics Institute and Bank of Spain.

[Data](#)

# Deleveraging of the private sector: households

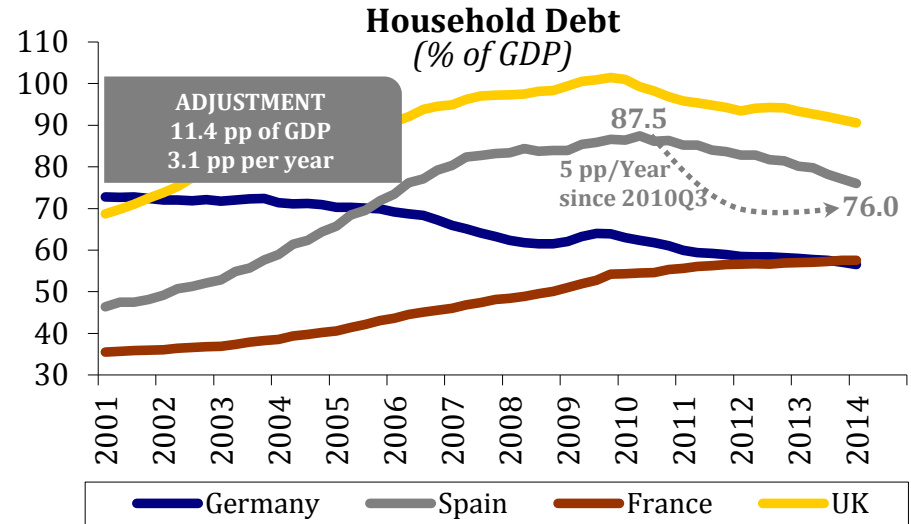
▶ Households have progressively reduced their leverage ratios and their debt has returned to 2007 levels

❑ Debt/GDP of Spanish households has declined from 87.4% in 2010Q2 to 76.0% by 2014Q1

▶ 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

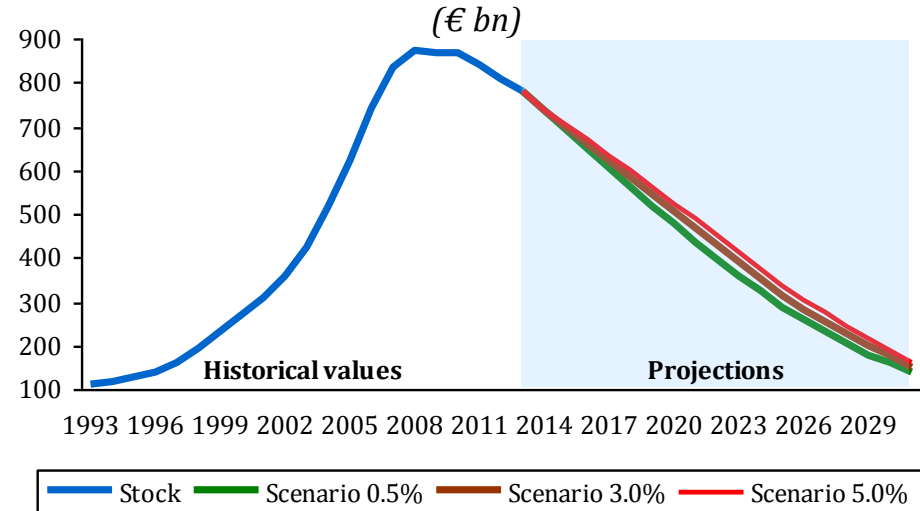
❑ By 2020-2023 the existing mortgage stock would be halved vs. today's levels



Source: ECB.

Data

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

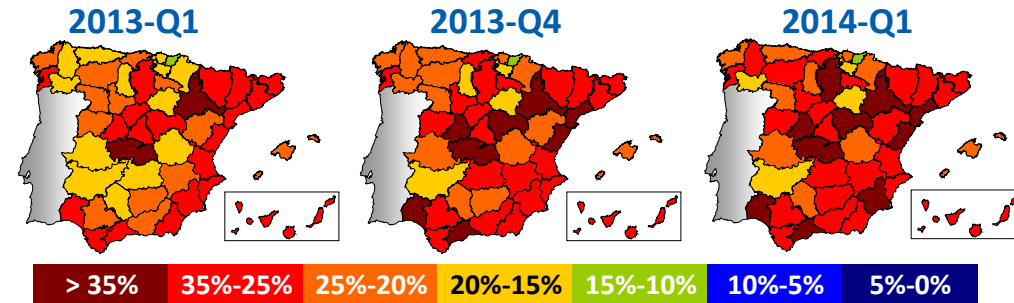


Source: Santander GBM Research.

# The construction sector has accelerated its adjustment

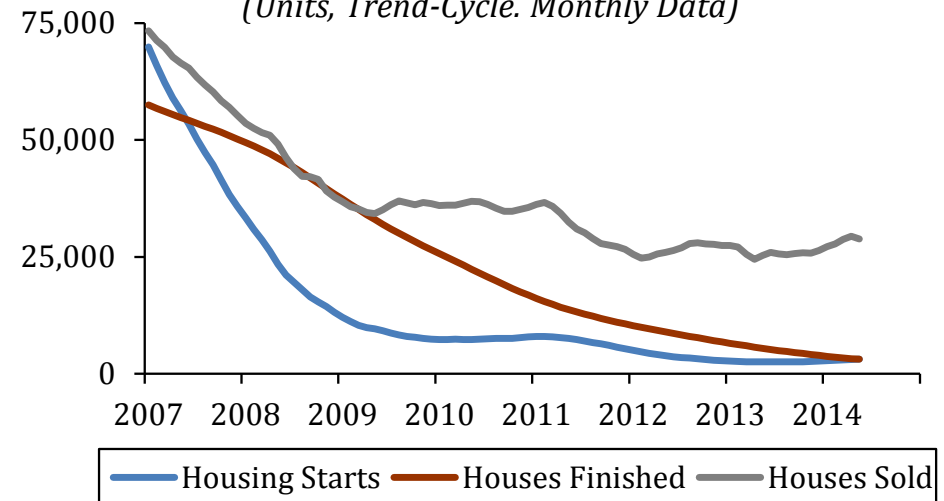
- ▶ Real estate prices have fallen on average by approx. 30% since the peak in 2008
- ▶ The adjustment has been very heterogeneous and more intense around most populated and coastal provinces
  - The average nominal price decline since the peak for new dwellings reaches 30%
- ▶ Significantly more houses 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

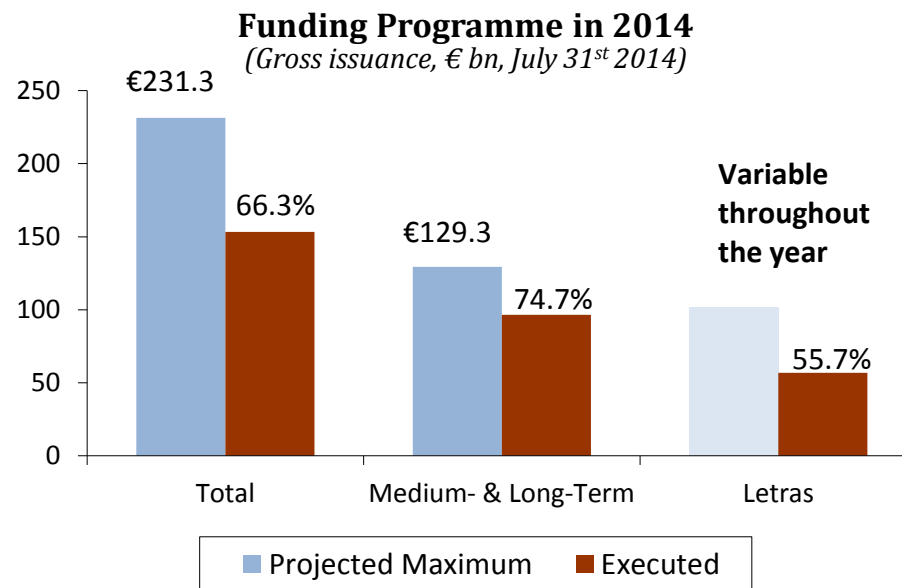
- ▶ The net funding in the Treasury's Funding Programme for 2014 has been revised downwards by €10 bn, in line with fiscal consolidation strategy for 2014
- ▶ Up to July 31<sup>st</sup> the Spanish Treasury has funded €96.6bn of the expected amount of medium- and long-term gross issuance
- ▶ Including Letras, the Spanish Treasury has issued €153.4 bn so far in 2014

<i>(billion euros, in effective terms)</i>	<i>January 2014</i>	<i>June 2014 Update</i>
<b>Total Net Issuance</b>	<b>65.0</b>	<b>55.0</b>
<b>Total Gross Issuance<sup>1,2</sup></b>	<b>242.4</b>	<b>231.3</b>
<b>Medium- and Long-Term</b>		
Gross Issuance <sup>2,3</sup>	133.3	129.3
Net Issuance <sup>3</sup>	65.0	61.0
<b>Letras del Tesoro</b>		
Forecast Gross Issuance <sup>1</sup>	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 strategy in 2014

2 Excluding additional issuance for early redemptions.

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



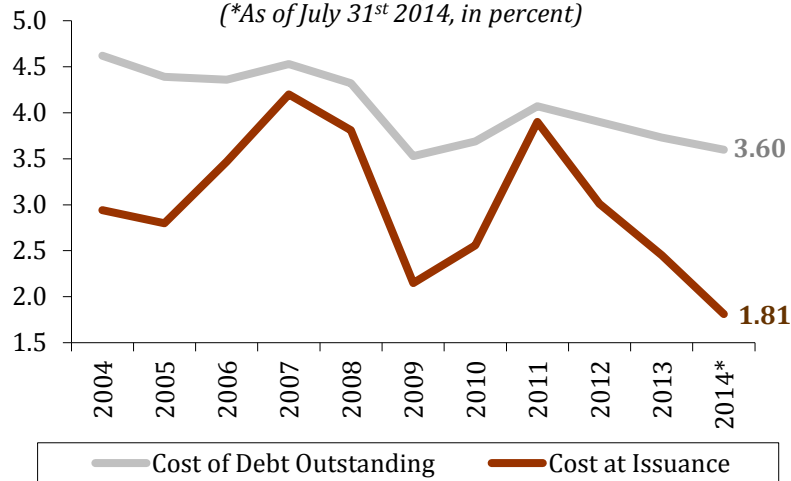
Source: Secretaría General del Tesoro y Política Financiera.

Data

# Cost and life of debt

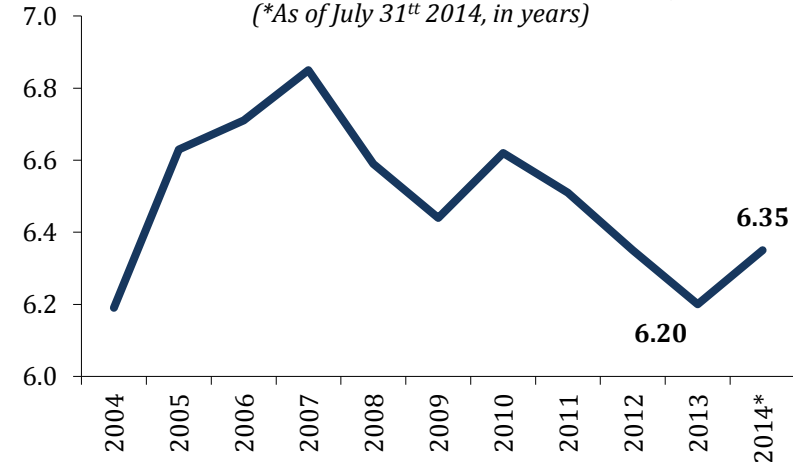
**Cost of Debt Outstanding and Cost at Issuance**

(\*As of July 31<sup>st</sup> 2014, in percent)



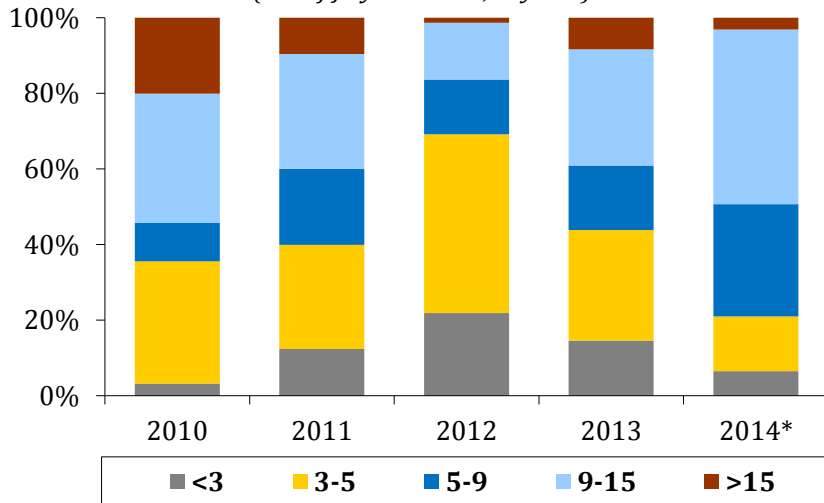
**Average Life of Debt Outstanding**

(\*As of July 31<sup>st</sup> 2014, in years)



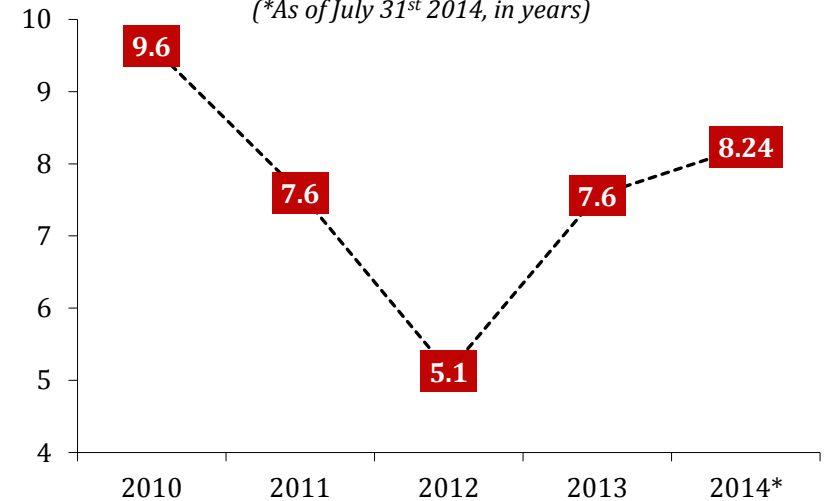
**Marginal Life at Issuance of Bonos and Obligaciones**

(\*As of July 31<sup>st</sup> 2014, in years)



**Average Life at Issuance of Bonos and Obligaciones**

(\*As of July 31<sup>st</sup> 2014, in years)



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.

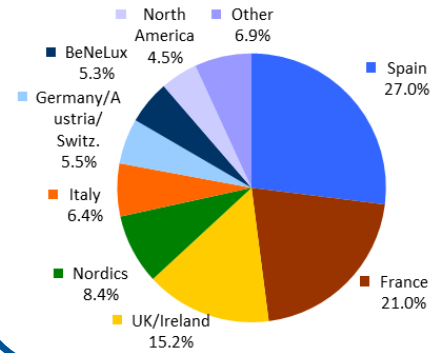
► This transaction initiates the Kingdom of Spain's Euro Area inflation-linked programme, as announced in its 2014 issuance Strategy for 2014

► 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)

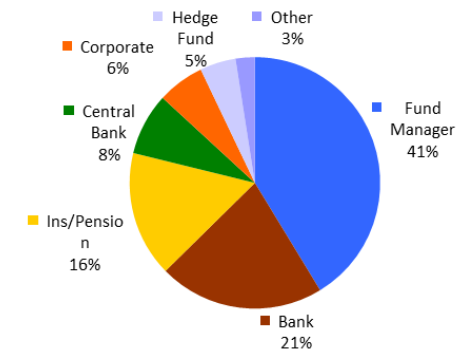
► The new €9bn (€3.7bn switch / €5.3bn cash) 10 year benchmark issue (due 31 October 2024) has a 2.750% coupon and was priced at a spread of 118 bps over mid swaps

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

Geographic Distribution (%)

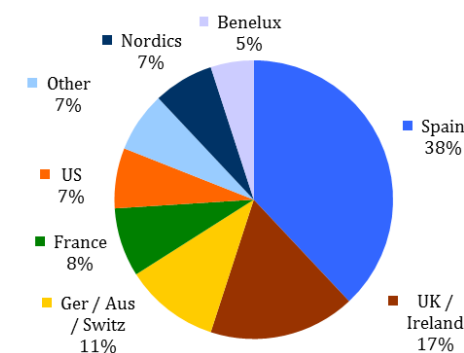


by Type of Investor (%)

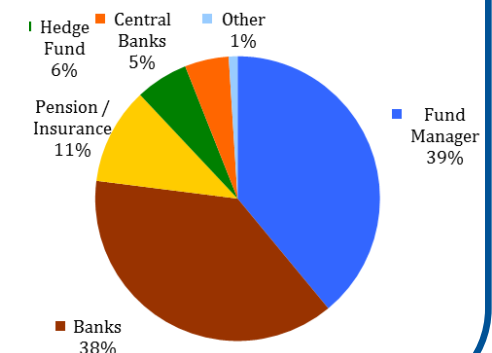


### JUNE - NEW 10 YEAR REFERENCE. OCTOBER 2024 CASH BOOK

Geographic Distribution (%)



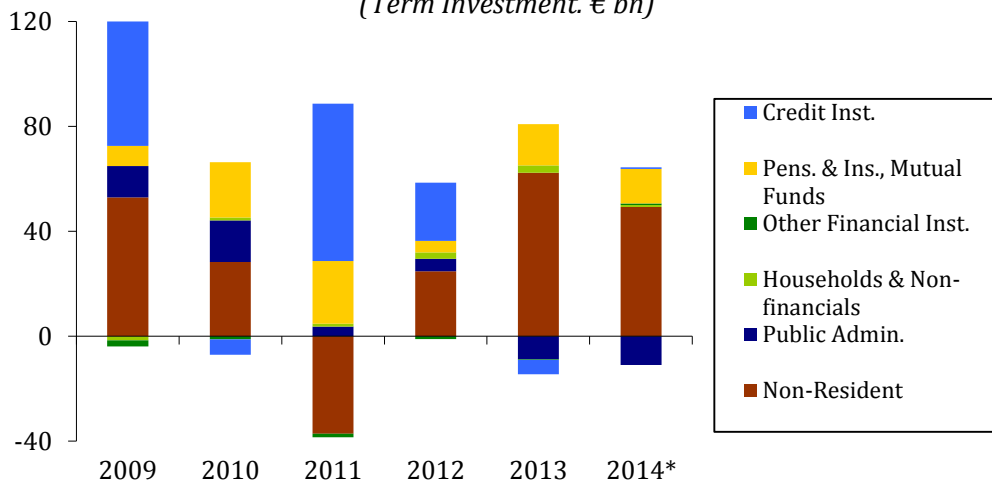
by Type of Investor (%)





# Recent trends in investor base

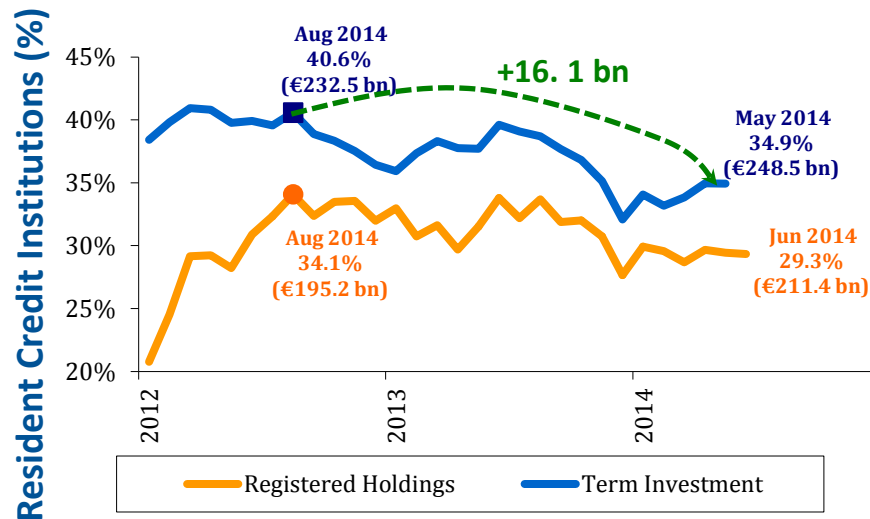
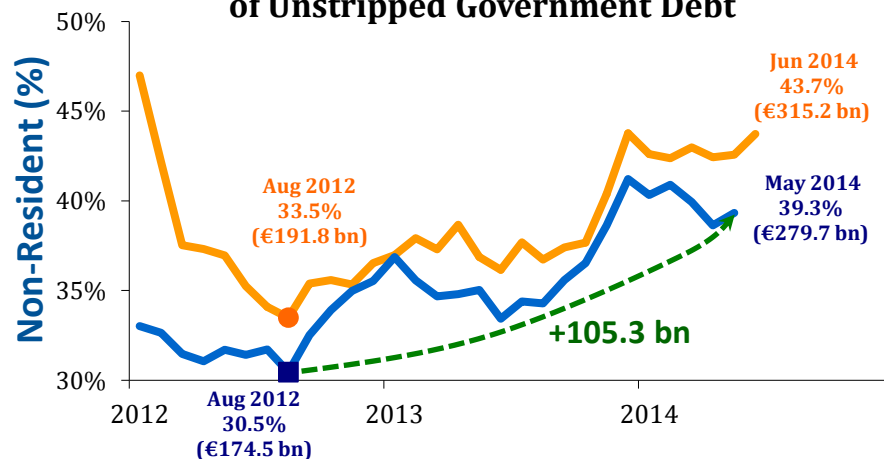
### Change in Term Investment by Investor Type (Term Investment. € bn)



Source: Secretaría General del Tesoro y Política Financiera.  
\* 2014: Year-on-year change. May 2013 to May 2014

Data

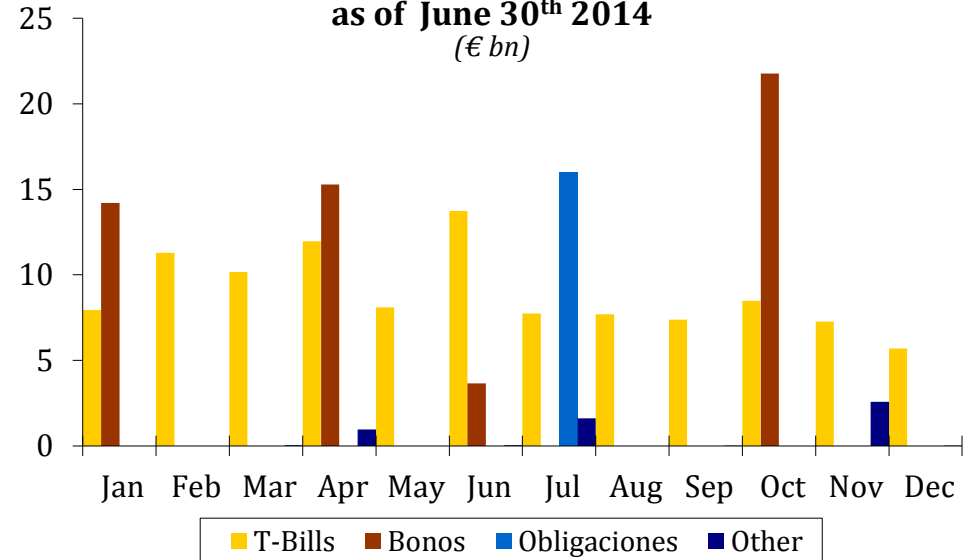
### Holdings of Unstripped Government Debt



# 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

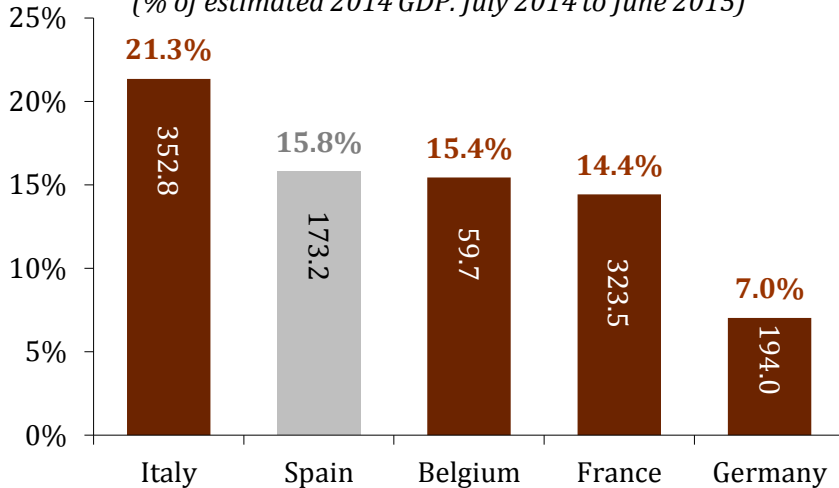
Monthly Maturity Structure in 2014  
as of June 30<sup>th</sup> 2014  
(€ bn)



Source: Secretaría General del Tesoro y Política Financiera.

[Data](#)

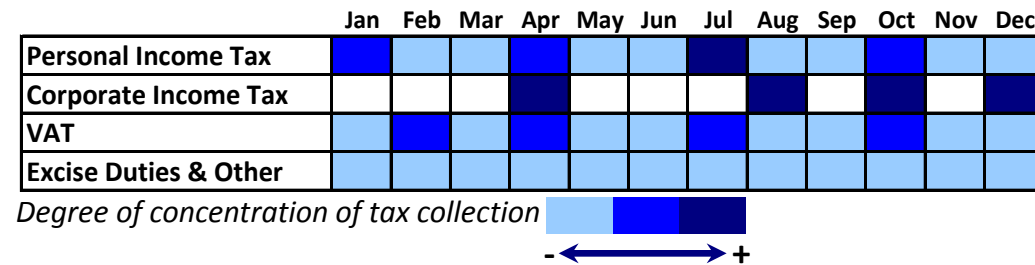
Relative Redemptions, including T-Bills  
(% of estimated 2014 GDP. July 2014 to June 2015)



Source: Secretaría General del Tesoro y Política Financiera for Spain, June 30<sup>th</sup> data for Italy, and Bloomberg for other countries.

[Data](#)

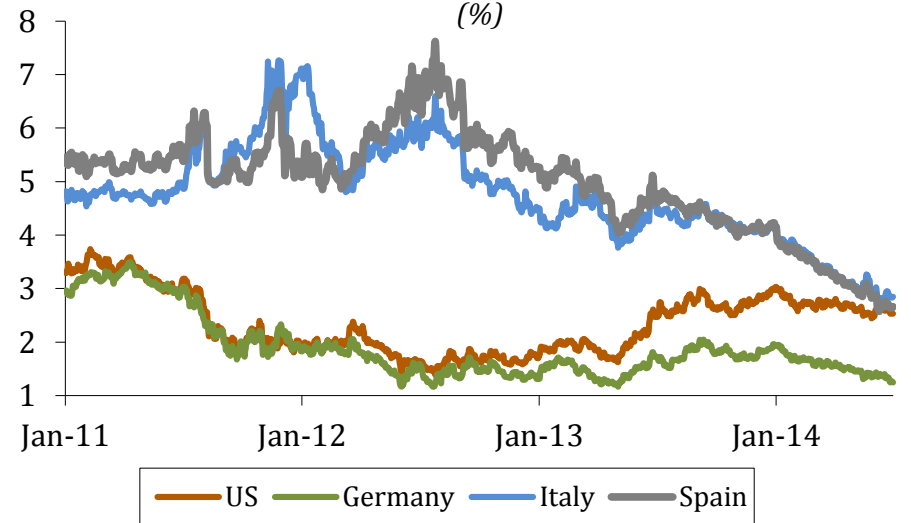
Administrative Distribution of Tax Collection



# Interest rate volatility has diminished

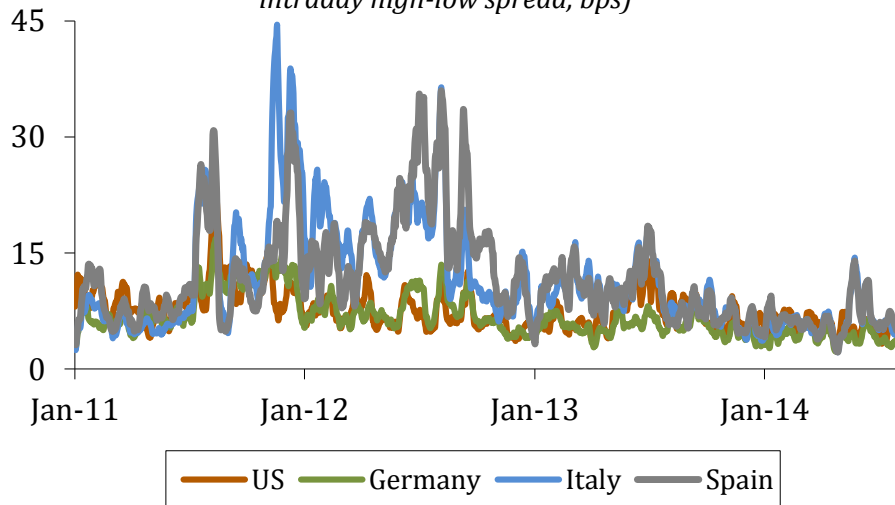
- ▶ Significant tightening in sovereign spreads
- ▶ Rates have stabilised for longer periods, enabling more efficient investment decisions by market agents

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



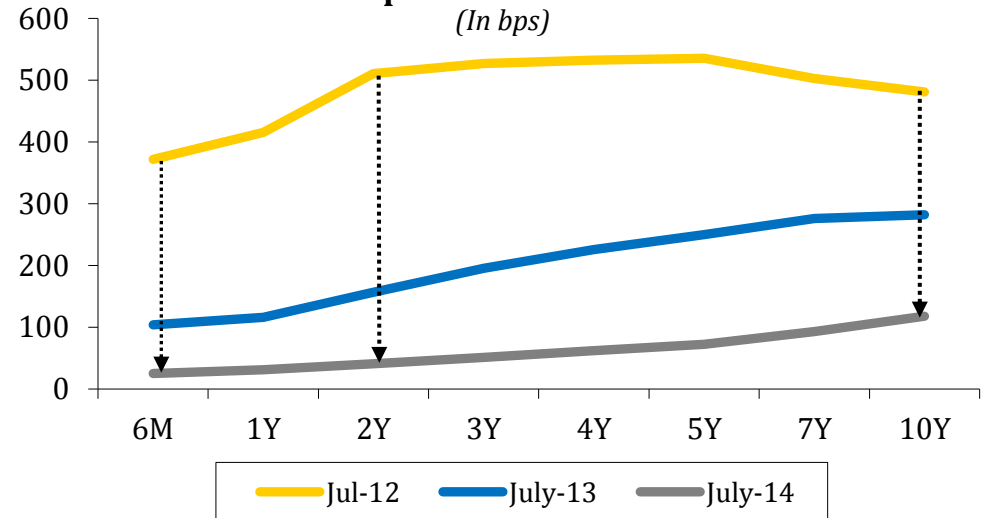
Intraday Yield Range, 10-Day Rolling Average

(Generic 10-year Government Bond yields intraday high-low spread, bps)



Spain CDS Curves (In bps)

(In bps)



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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