Economic Policy Strategy and Funding Programme

October 2014

Introduction

- Structural reforms implemented by the Spanish Government allow an increased effectiveness of demand-side economic policies, with positive impact on economic growth
- The path of structural reforms continues into 2014 and 2015:
  - Active labour market policies
  - Fostering internationalisation of Spanish firms
  - Reform of the debt restructuring & insolvency framework
  - Fiscal reform
- Central Government Draft Budgets build on structural reforms
- Stimulus measures announced by the ECB will impact on the real economy
- Banking Union. A robust and complete Monetary Union:
  - Single Supervisory Mechanism
  - Approval of a uniform solvency regulation (CRD-IV)
  - Common resolution framework (BRRD)
  - Single Resolution Mechanism

1. Spanish Economic Policy

2. Transformation of Spain's Growth Model

3. The Funding Programme of the Spanish Treasury

Macroeconomic scenario

- Reforms have positively impacted on potential growth
- Forecasts in line with national consensus: higher growth stemming from private national and external demand & spurred by investment
- AIReF endorses the macroeconomic forecasts provided by the government as probable

Macroeconomic scenario (Year-on-year growth rates in percent)	2013	2014(f)	2015(f)
Private consumption	-2.3	2.0	2.1
Government consumption	-2.9	0.2	-1.0
Gross Fixed Capital Formation	-3.7	1.5	4.4
National Demand*	**-2.7**	**1.4**	**1.8**
Exports of goods and services	4.3	3.6	5.2
Imports of goods and services	-0.5	4.4	5.0
External demand*	**1.4**	**-0.1**	**0.2**
Gross Domestic Product	**-1.3**	**1.3**	**2.0**
GDP - EC Spring Forecast (May 2014)	..	1.1	2.1
GDP - IMF WEO (Oct. 2014)	..	1.3	1.7
GDP - OECD (Sep. 2014)	..	1.2	1.6

Other macroeconomic variables	2013	2014(f)	2015(f)
Unemployment rate (in %)	26.1	24.7	22.9
Full-time Equivalent Employment (Year-on-year)	-3.3	0.7	1.4
Unit Labour costs (Year-on-year)	-0.4	0.2	0.4
GDP deflator (Year-on-year)	0.7	0.1	0.6
Net lending(+)/borrowing(-) with RoW (% of GDP)	2.1	1.5	1.7
Deficit Excl. Financial Sector One-Offs	-6.3	-5.5	-4.2
Primary Deficit(-)/Surplus(+) Excl. Financial Sector	-3.1	-2.2	-0.8
Debt/GDP ratio (in % of GDP)	92.1	97.6	100.3

Underlying assumptions	2014(f)	2015(f)
Short-term interest (3m Euribor rate)	0.2	0.2
Long-term interest (sovereign 10y debt)	2.8	2.6
USD/€ exchange rate	1.35	1.30
World GDP growth	3.3	3.9
EU GDP growth	0.9	1.6
Oil prices (Brent, USD/barrel)	106.2	104.1

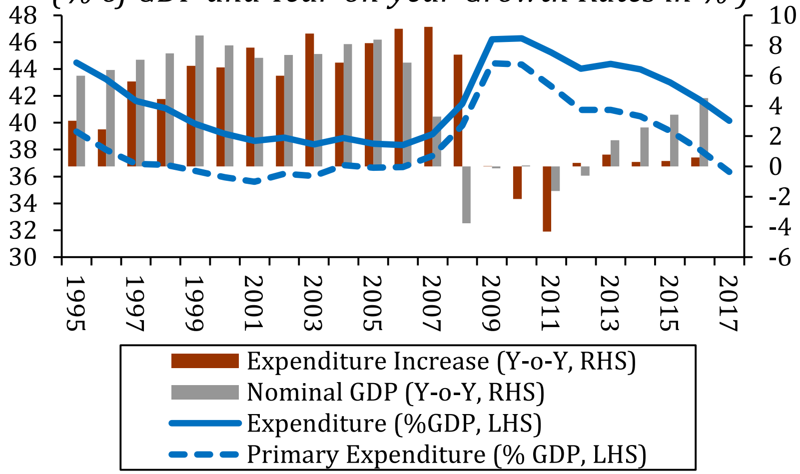
Sources: Ministerio de Economía y Competitividad, OECD, IMF and European Commission.

** Contributions to GDP in p.p.*

The Draft Central Government Budgets for 2015

- Economic effects of tax-reform dominate lower implied tax collection: overall tax collection expected to increase 5.4% y-o-y, roughly in-line with the observed increase in 2014 despite cuts in effective tax rates
- Lower subsidies & transfers drive the adjustment of the expenditure-side: building up on efficiency reforms (CORA Measures) and the reform of the Public Administrations

Expenditure Trajectory
(% of GDP and Year-on-year Growth Rates in %)



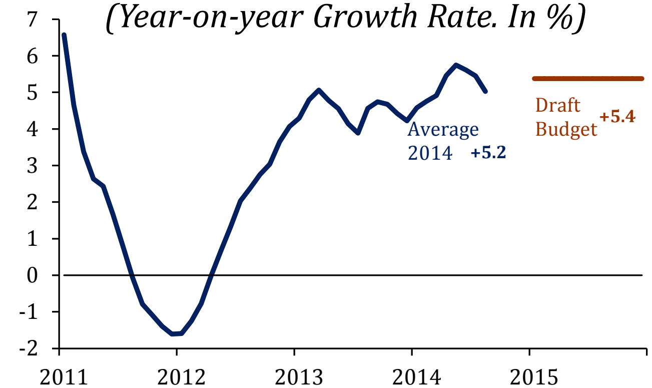
Source: Ministerio de Hacienda y Administraciones Públicas.

Links to detailed information (*Spanish*): [Presentation] [Yellow Book] [Draft Budgetary Plan]

Ex-Ante Impact of the Fiscal Reform			
(In € mn)	2015	2016	Total
Personal Income Tax	-3,366	-2,615	-5,981
Corporate Income Tax	-437	-2,641	-3,078
TOTAL	-3,803	-5,256	-9,059

+ 2nd round effects

Tax collection. Actual and Draft Budget.
(Year-on-year Growth Rate. In %)



Tax Collection by Item (In € bn)	2014 Budget	2014 Forecast	2015 Budgets	Y-o-Y
Personal Income Tax	73.2	73.4	73.0	-0.6%
Corporate Income Tax	22.3	19.6	23.6	20.4%
VAT	54.8	56.2	60.3	7.2%
Excise Duties	20.5	19.1	19.9	4.4%
Other	8.9	8.4	9.4	12.9%

Source: Ministerio de Hacienda y Administraciones Públicas. [Data]

The fiscal path of the Public Administrations 2014-2017

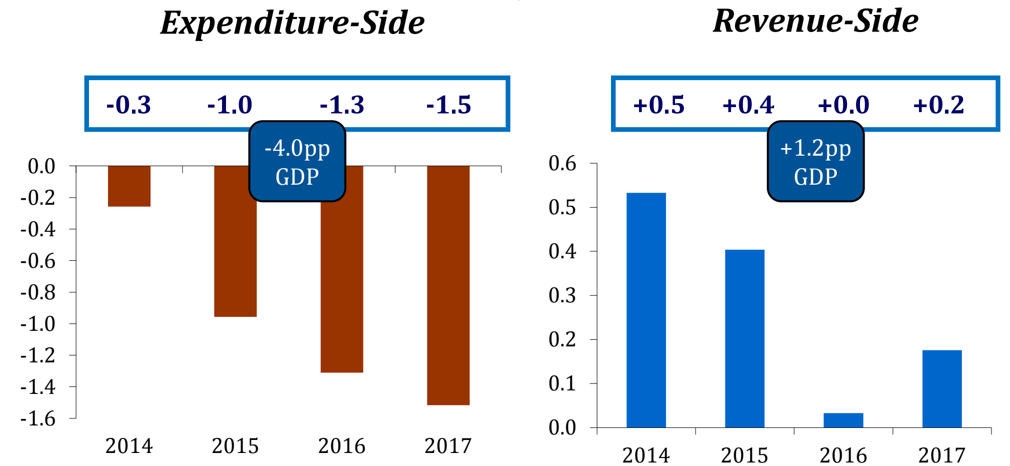
- 2014 deficit target revised down to 5.5% of GDP in April
- Emphasis on expenditure reduction (4pp of GDP between 2014 and 2017); mainly driven by efficiency gains in the Public Administrations
- Incorporates impact on tax collection of the tax reform (2015-2016 total: ex-ante approx. €9.1 bn; ex-post impact after second round effects €6.9 bn)

Net Lending(+)/Borrowing(-) of the General Government. Excl. Financial Sector One-Offs

(% of GDP)	2013	Forecast 2014	2015	2016	2017
Central Government	-4.2	-3.5	-2.9	-2.2	-1.1
Autonomous Regions	-1.5	-1.0	-0.7	-0.3	0.0
Local Governments	0.5	0.0	0.0	0.0	0.0
Social Security Administrations	-1.1	-1.0	-0.6	-0.3	0.0
General Government	**-6.33**	**-5.5**	**-4.2**	**-2.8**	**-1.1**
Primary Balance	**-3.1**	**-2.2**	**-0.8**	**0.6**	**2.3**
Structural Primary Balance	**2.2**	**2.7**	**2.9**	**2.8**	**3.0**
Nominal Adjustment	**0.3**	**0.8**	**1.4**	**1.3**	**1.7**
Financial Sector one-offs	**0.5**	**0.1**	**-**	**-**	**-**

Source: Ministerio de Economía y Competitividad. Data

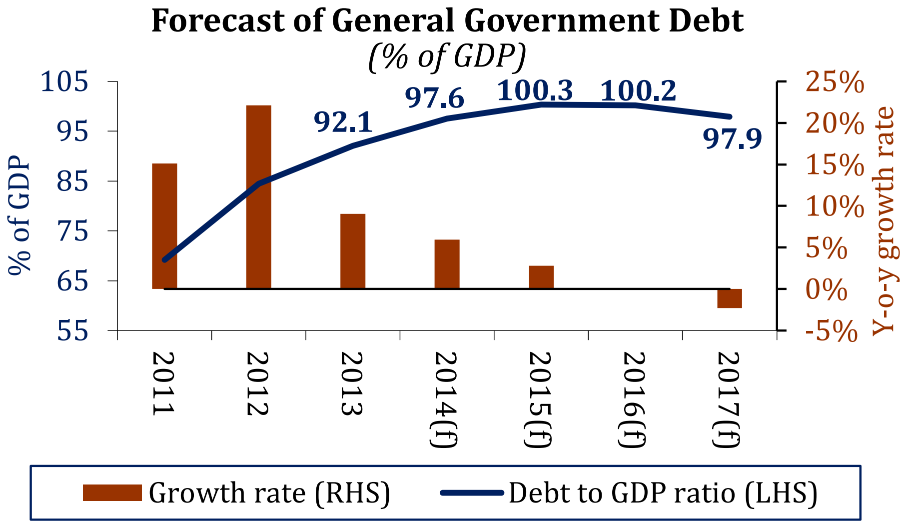
Changes to the fiscal balance
(% of GDP)



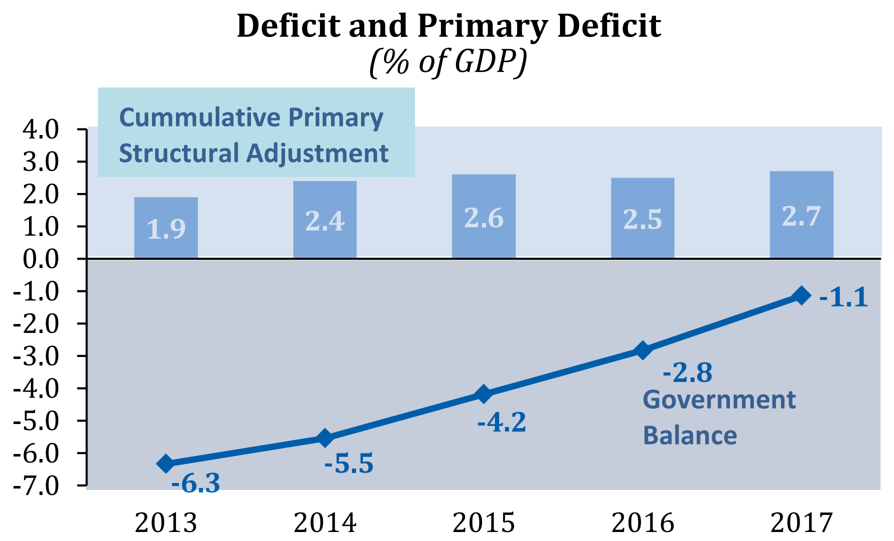
Source: Ministerio de Economía y Competitividad. Data

Debt/GDP dynamics 2014-2015

- Debt to GDP ratio to peak above 100% of GDP in 2015
- Primary surplus to be reached in 2016, reversing the Debt to GDP trajectory
- Achievement of structural surplus in 2017, ensures the decline in the ratio and reinforces the downward trend
- Impact stemming from one-off components has eroded (Fund for Payment to Suppliers, financial sector recapitalisation, FADE, etc.)



Source: Ministerio de Economía y Competitividad. Data



Source: Ministerio de Economía y Competitividad. Data

Budgetary execution in 2014

- Monthly budgetary execution highlights:

❑ <u>Central Government</u> (*July 2014 data*): the combined deficit of the Central Government Administration and the autonomous entities of the Central Govt. reached €41.2 bn

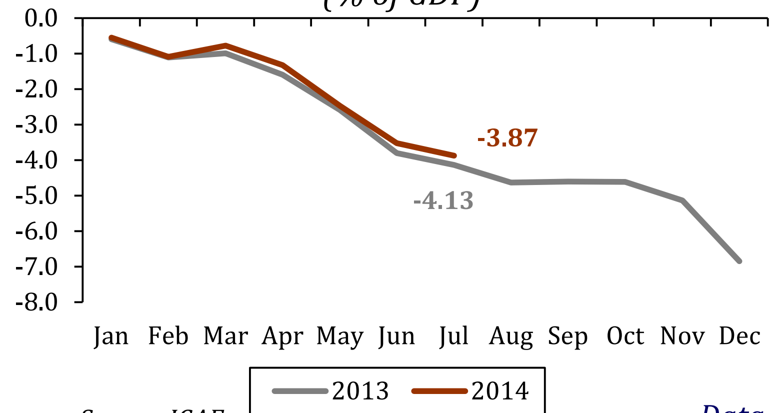
- <u>Central Gov. Administration</u> (*August 2014 data*): deficit €34.7 bn vs. €39.6 bn in August 2013; primary deficit down to €14.9 bn vs. €20.8 bn in August 2013
  - ✓ Income increased by 4.5% y-o-y
  - ✓ Expenditure decreased by 0.2% y-o-y

❑ <u>Regional Governments</u> (July 2014 data): deficit reached €10.5 bn

❑ <u>Social Security Administrations</u> (*July 2014 data*): the Social Security posted a deficit of €0.5 bn

Combined Deficit of Central & Regional Governments and Social Security Administrations. Excl. Financial Sector Recapitalisation

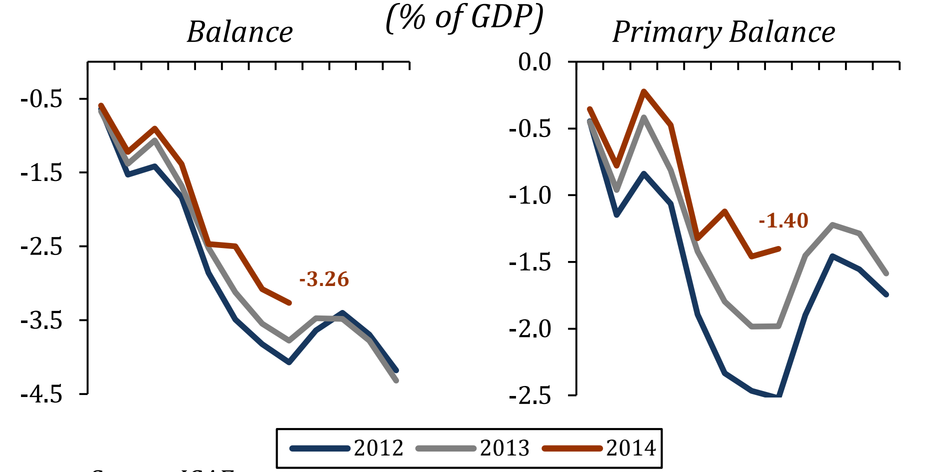
(% of GDP)



Source: IGAE. <u>*Data*</u>

Breakdown of the Budget Balance of the Central Government Administration Excl. Financial Sector Recapitalisation

(% of GDP)



Source: IGAE.
Up to August 2014 <u>*Data*</u>

STRUCTURAL REFORMS

The reform process continues

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 Active Labour Market Policy Framework
- Reform of the Tax System
- New Legal Framework for Disintermediation and Promotion of Capital Markets for SMEs
- Measures to Facilitate Corporate Recovery & Debt Restructuring

  Reform of the Insolvency Regime

Economic Structural Reforms

Public Sector Reforms

Financial Sector Reforms

Links to detailed presentations describing the Reform Agenda

Balance Reforms. Two and a Half Years in Government

OECD: CORA Reforms

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 and approved on October 8th 2014

Transparency Law

Independent Fiscal Responsibility Authority

Commission for the Reform of the Public Sector

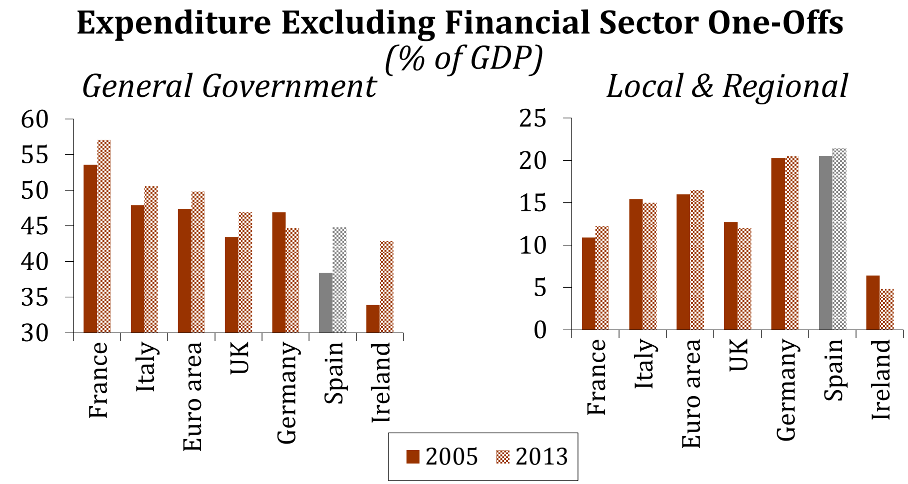
Reform of the Local Authorities

Tax Reform

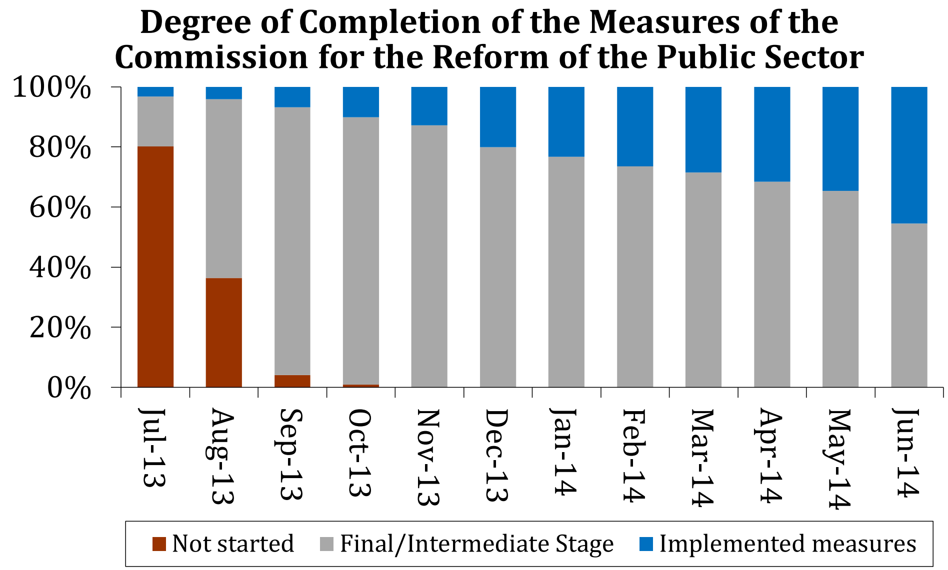
Electronic Billing Law

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 structural measures to streamline expenditure and to reform the State Administrations



Source: Eurostat. Data



Source: Ministerio de Hacienda y Administraciones Públicas. Data

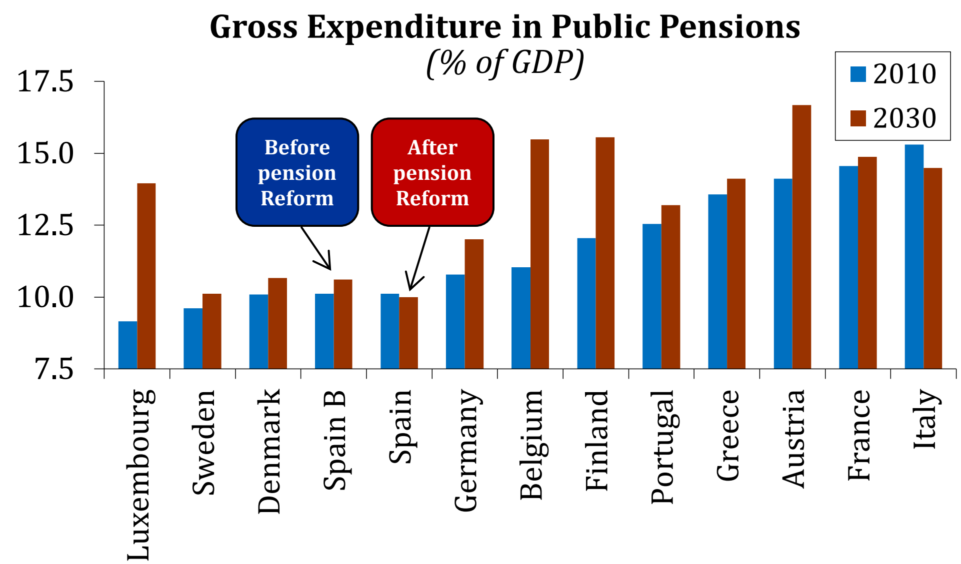
Tax reform: draft law

- The Government's draft law was presented on June 20th
- Aims at reducing taxation on labour, to strengthen competitiveness, to promote saving and investment, and modernise Personal and 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
▶ Reduction in number of tranches and rates in two years	▶ Lower rates in two years and more progressive	▶ Reduced general rate: from 30% to 25% in two years (reduced rate for new firms 15%)	▶ Health care products VAT rate adapted to ECC regulations: -Intermediate products for drug development, medical instruments and equipment, medical devices and pharmaceutical products	▶ Lists of defaulters to be published	▶ 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
▶ 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	▶ Elimination of tax deduction for dividends	▶ In the case of the financial sector kept at 30%		▶ Annual publication of tax havens	
	▶ Capital gains generated in less than 12 months no longer penalised	▶ 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)		Tax audit process: New deadlines and suspension of Statutes of Limitation in specific situations	
	▶ New savings instrument: savings or insurance schemes maintained longer than five years ('Cuenta Ahorro 5'): exempt form capital gains tax		▶ New rules on the localisation of assets; taxing at destination of electronic, telecommunications and radio-television services when the addressee is a private individual	▶ Administrative assessment in evidence of tax fraud	▶ Companies investing more than 10% of their accounting net income in R&D will extend their percentage of deduction to 50%.
▶ Limits to exemptions to severance payments in case of unjustified dismissal				▶ Tax assessment cases are extended to smuggling offenses	
▶ Tax deductions for house rental: - Elimination for new rentals (Expenditure side) - Lower tax deductions for house rentals (Income side)		▶ Update and simplification of depreciation tables		▶ Better precision in the indirect assessment regime	
▶ Lower tax withholding for professional and self-employed workers with incomes below €15,000	▶ Limit for deductible contributions linked to pension plans lowered to €8,000/year	▶ No deductibility of equity securities impairments extended to fixed income portfolios and fixed assets		▶ Imprescriptibility of the Administration's right to check tax credits derived from statute-barred tax years	▶ Incentives for cultural activities
▶ Limits to simplified method ('Modulos') to certain professional activities	▶ Better fiscal treatment in case of assets received in lieu of payment if affected by preference shares	▶ General limit 60% for Tax loss carryforwards as from 2016		▶ Interruption of the limitation period of related tax obligations	
▶ Elimination of abatement coefficients and monetary correction gains		▶ To maintain income from the CIT, in 2015 previous measures maintained			

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:
  - 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



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
➡ 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	➡ Avoiding lay-offs: rigidity fostered job cuts as a means of adjusting to economic changes ➡ Lack of flexibility avoided innovation and gains in competitiveness	➡ Reduction of severance pay for unfair dismissals ➡ Clear and objective regulatory framework of fair dismissals	
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)	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	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	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 has reformed its public employment services and launching new tools to fight against.

ACTIVATION POLICIES

PLANNING + COORDINATION REGIONAL GOVERNMENTS

- **Multi-annual Activation Strategy**
- **Annual Employment Plans**
  - Common concepts, objectives and strategy
  - Result-oriented measures to increase efficiency
  - Funding linked to results
  - Efficiency monitoring through common sets of indicators
  - Sharing and implementation of best practices
  - Common IT system

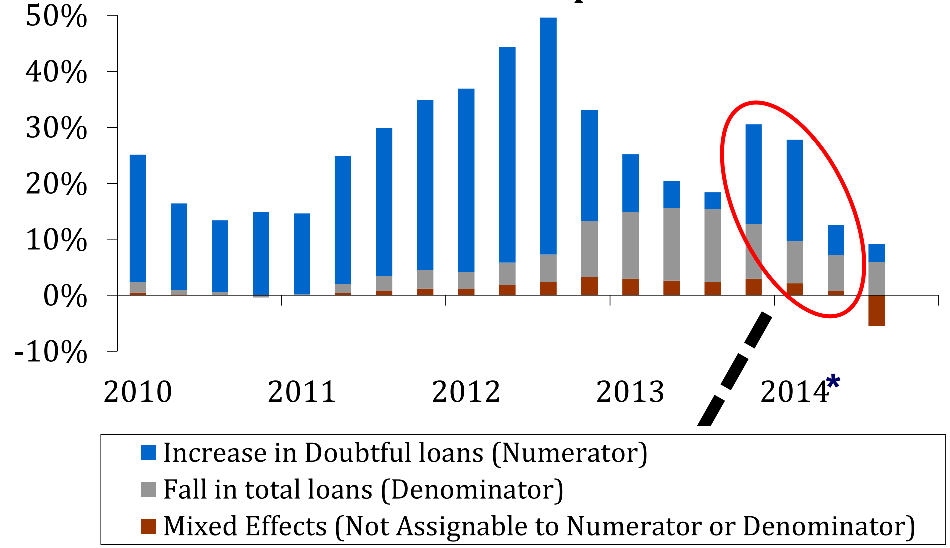
TOOLS

- **Training for the employment**
  - Training priorities linked to real needs
  - Open competition to select providers
  - Monitoring, supervision and transparency
  - Online training
  - Professional certificates
  - **Vocational training national Strategy**
- **Labour intermediation**
  - Private-public collaboration
  - Common rules to select providers
  - **National employment website**
- **Hiring subsidies**
  - Improved design of hiring subsidies
  - Better monitoring *ex ante* and *ex post*
- **Unemployment benefits**
  - Rationalization, better targeting, conditionality
  - Closer linkage to active labour policies
- **Youth guarantee**
- **Youth Employment and Entrepreneurship Strategy**

Enhanced transparency and refinanced loan provisioning requirements

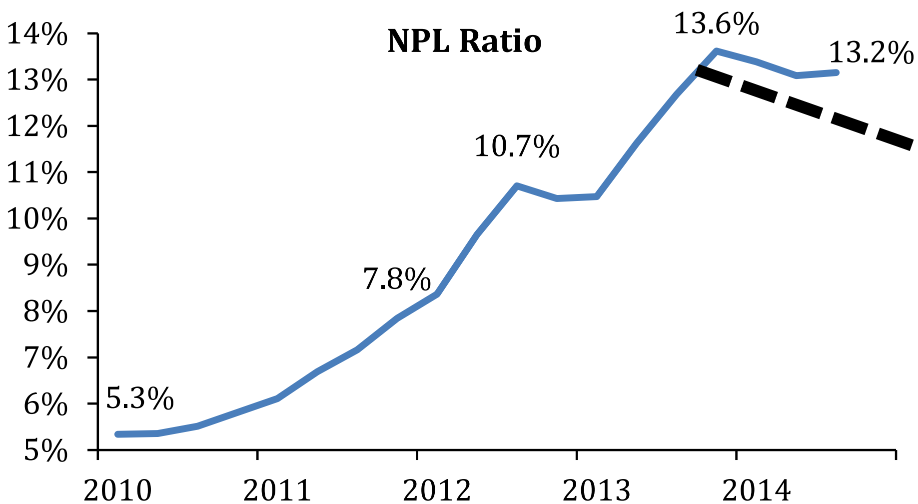
- Increase in the quality and quantity of information provided by banks, including on refinanced loans
- Disclosure requirements have been enhanced and harmonised for all entities in key areas of their portfolios such as restructured and refinanced loans, NPLs, asset quality across asset classes, concentration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

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



Source: Bank of Spain.
** Last: July 2014 over July 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 2014 Financial Sector Reform

- The previous insolvency regime and the obstacles to agreement between debtors and creditors generated strong inefficiencies and legal uncertainty
- This new framework enhances the solvency of non-financial and financial creditors

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
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		

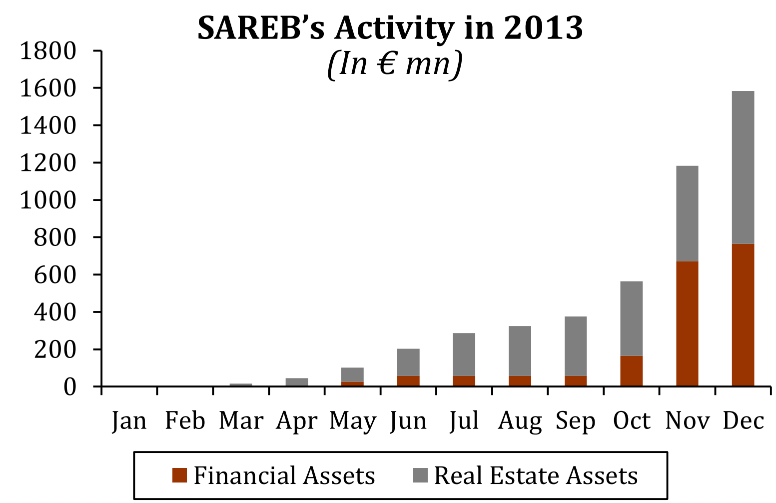
- Provides legal certainty
- Financial creditors not in a worse position
- Avoids closing down viable firms
- Frees up capital and funding for viable firms
- Better provisioning framework

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
- In the first six months of 2014 Sareb has sold 8.104 RE properties, close to its full-year target of 11.000 units
- 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*

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Transforming Spain's economic model

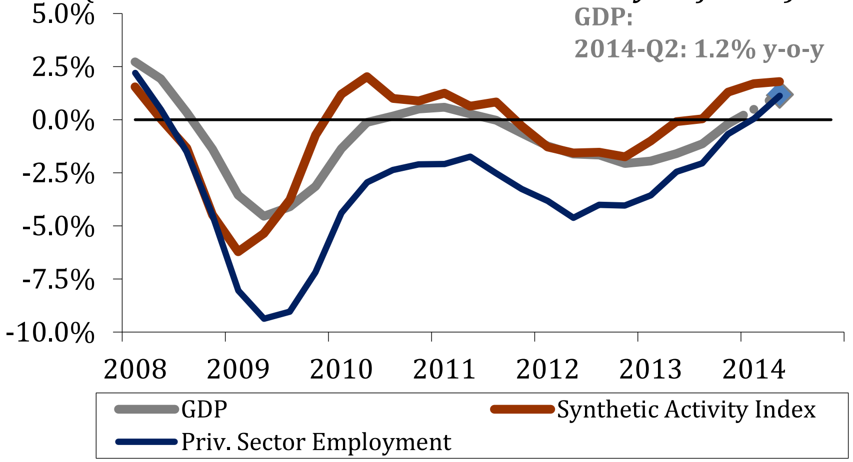
- The weight of exports in GDP has increased from 22.7% in 2009 to 31.7% in 2013
- The economy has evolved from being a net debtor one to a net lender to the rest of the world. The structural CA deficit has eroded notably; recent trends in merchandise exports support this process despite transitory cyclical deficits linked to investment in capital goods
- 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
  - Households' and Non-financial firms' debt levels have adjusted considerably in the last quarters
  - Re-composition of the asset/liability structure of firms' balance sheets, together with recent legislative initiatives on private debt-restructuring and on the insolvency regime, reinforce the deleveraging process

Recent coincident and leading indicators confirm the economic recovery

- Structural reforms implemented by the Spanish Government allow an increased effectiveness of demand-side economic policies, with positive impact on economic growth
- Forthcoming stimulus measures announced by the ECB expected to have a positive impact on the real economy
- Recent coincident and leading indicators point towards an expansion, especially in the services sector

GDP and Private Employment Growth vs Synthetic Activity Index

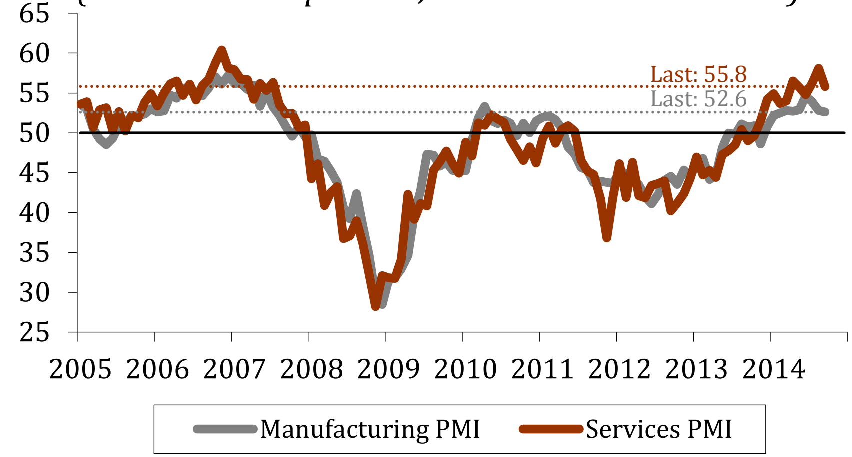
(Year-on-Year Growth Rates. Seasonally Adjusted)



Source: Ministerio de Economía y Competitividad, Data

Manufacturing and Services PMI

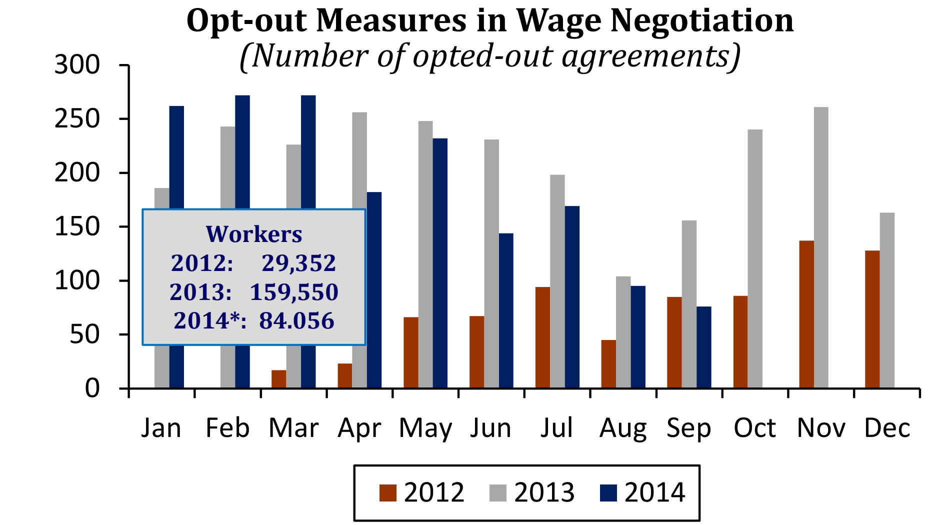
(Above 50 → Expansion; Below 50 → Contraction)



Source: Ministerio de Economía y Competitividad, Data

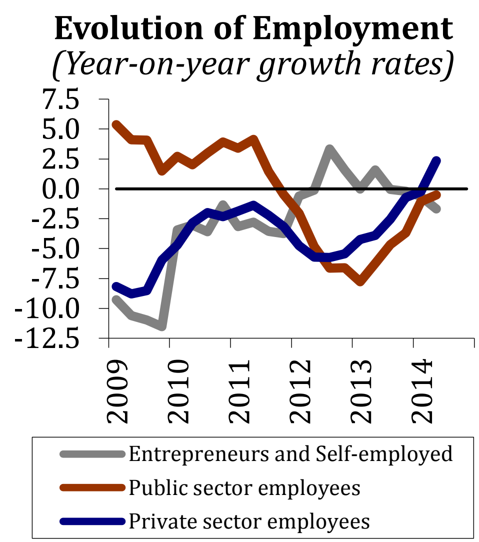
Labour market reform: wage moderation and enhanced flexibility mechanisms

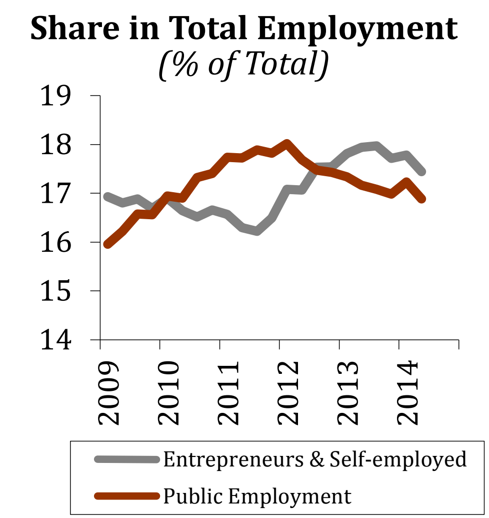
- The reform has eased opting out from collective agreements; mostly linked to wage negotiation (approx. 90% of all opting-outs clauses in 2013)
  - ❑ Phasing out of automatic renewal of expired collective agreements, and increasing number of new agreements, have accelerated wage moderation
- Acceleration 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 increasing since end-2013, for the first time since early 2008
- The 2014 reform of the Activation Policies will have a special incidence on productivity, on youth and structural unemployment



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

Data



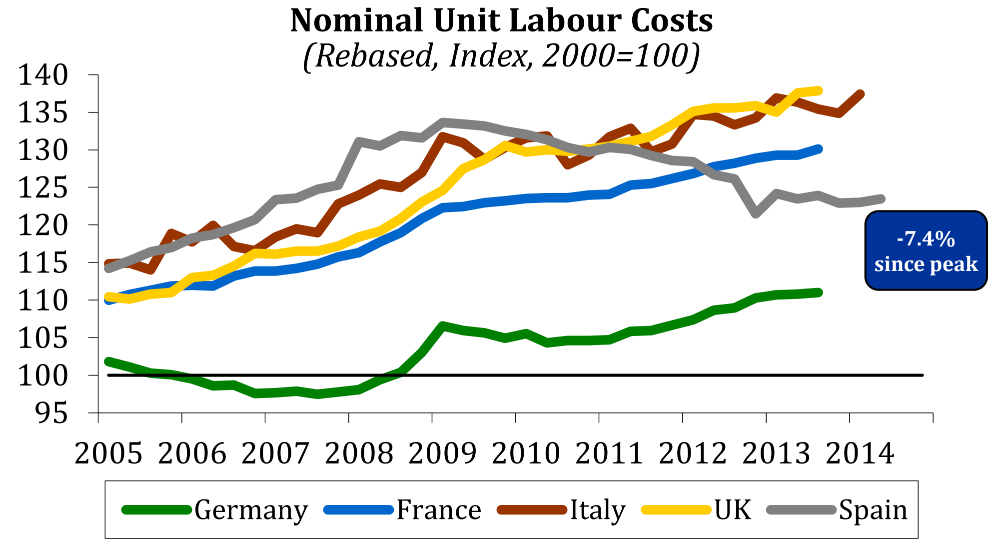


Source: National Statistics Institute.

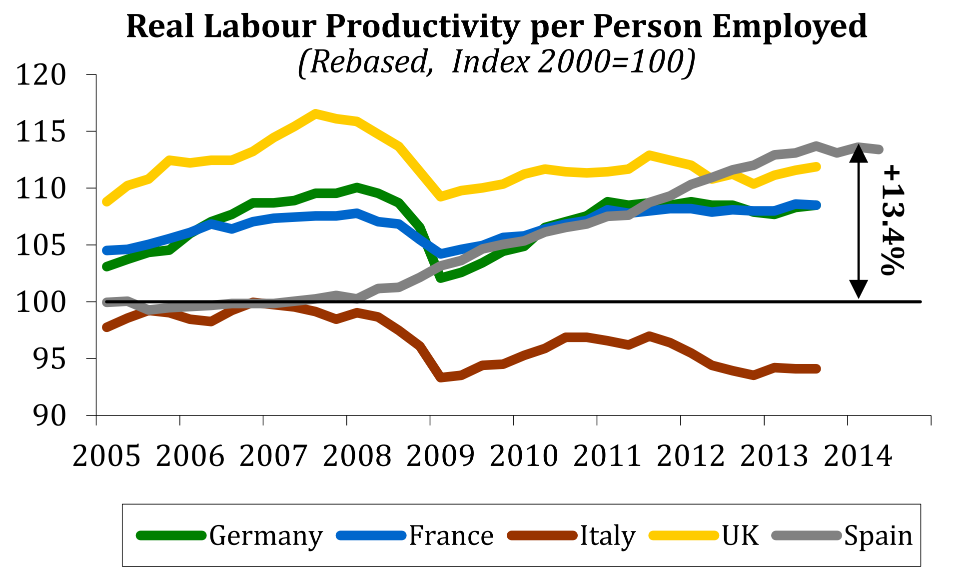
Data

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

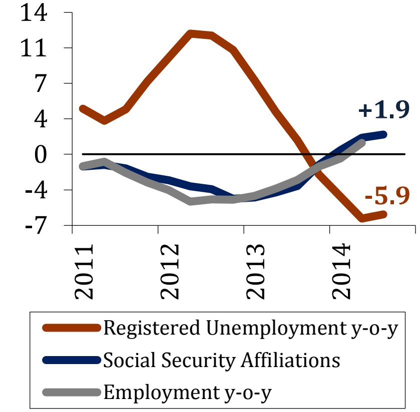


Source: Eurostat. Data

Lower growth needed for employment creation in the private sector

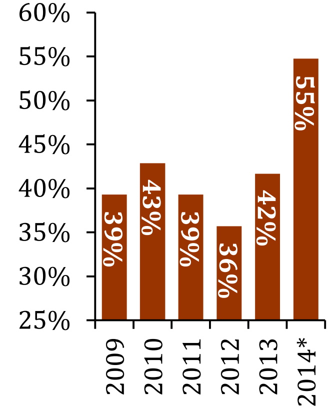
- New regulatory framework has affected the minimum GDP growth required for net private sector job creation, while maintaining productivity growth
- Increased employment and more broad-based: 55% of branches, social security affiliations +1.9% y-o-y

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



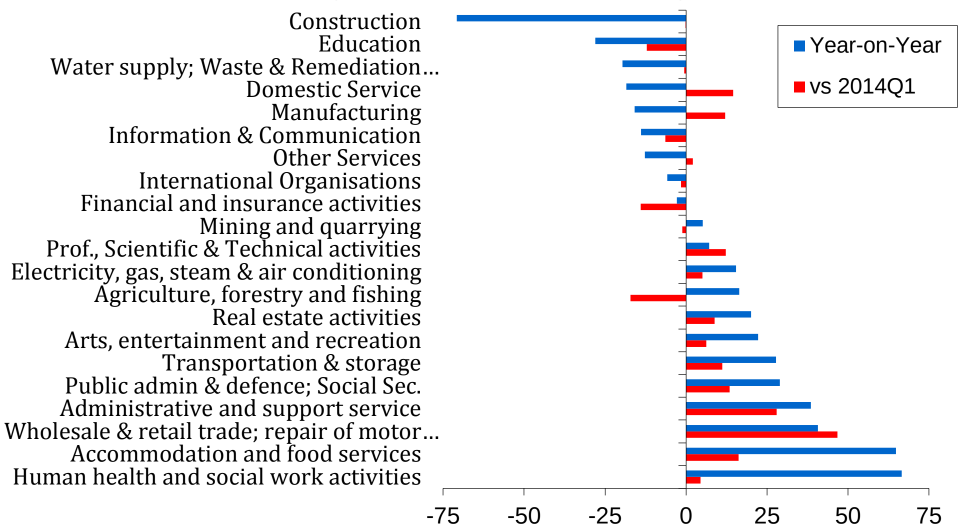
Source: National Statistics Institute. Data

% of Sectors with Quarterly Employment Growth
(Annual Averages)



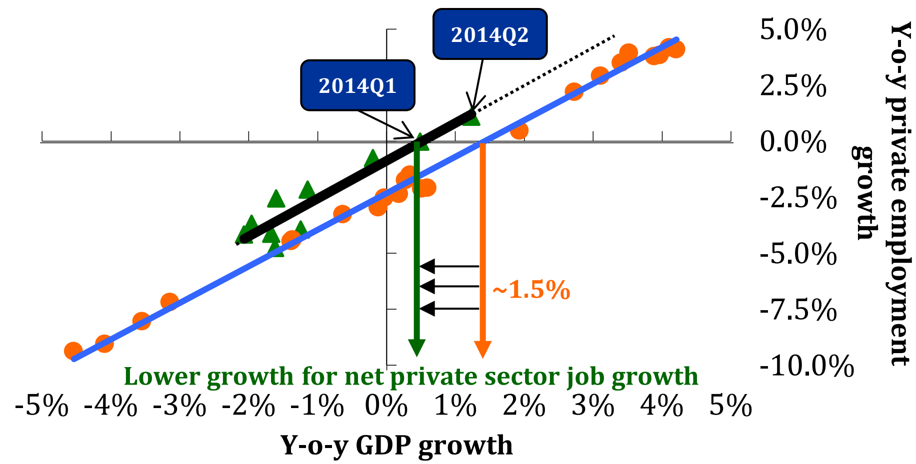
Data

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



Source: National Statistics Institute. Data

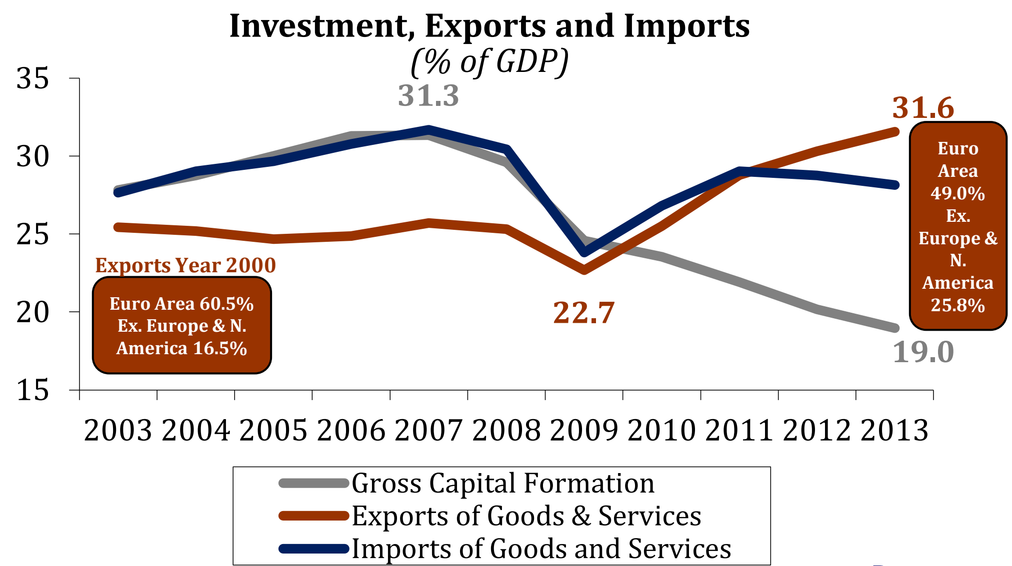
Growth Required for Private Employment Creation
(Quarterly Data, Seasonally and Calendar Adjusted)



Source: National Statistics Institute. Data

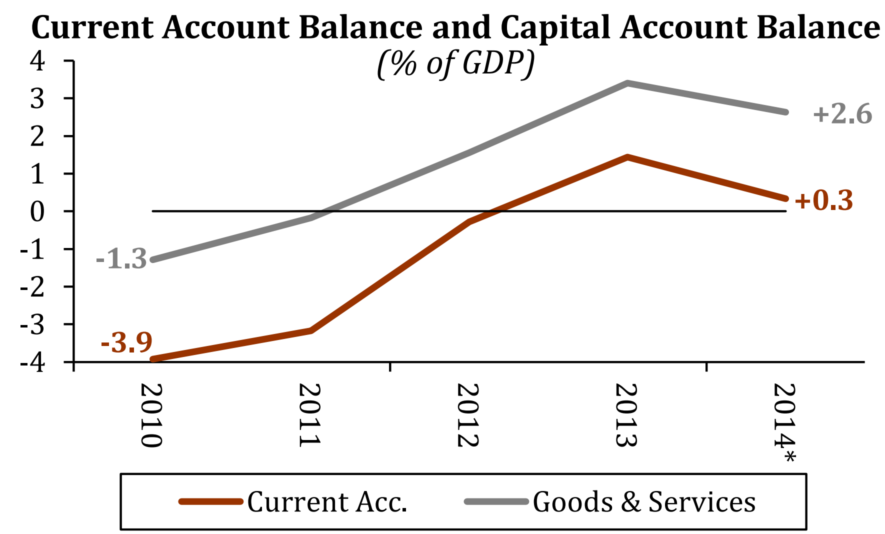
Rapid expansion of the external sector

- As a reflection of the structural change in the Spanish economy the weight of exports in GDP has increased from 22.7% in 2009 to 31.6% by 2013, while the weight of investment has declined substantially, from over 31% of GDP to 19% in 6 years
- Cumulative Current Account from August 2013 to July 2014: +0.3% of GDP, linked to higher imports of capital goods
- Current Account plus Capital Account (equivalent to net lending/borrowing capacity) stands at +0.9% of GDP



Source: National Statistics Institute.

Data



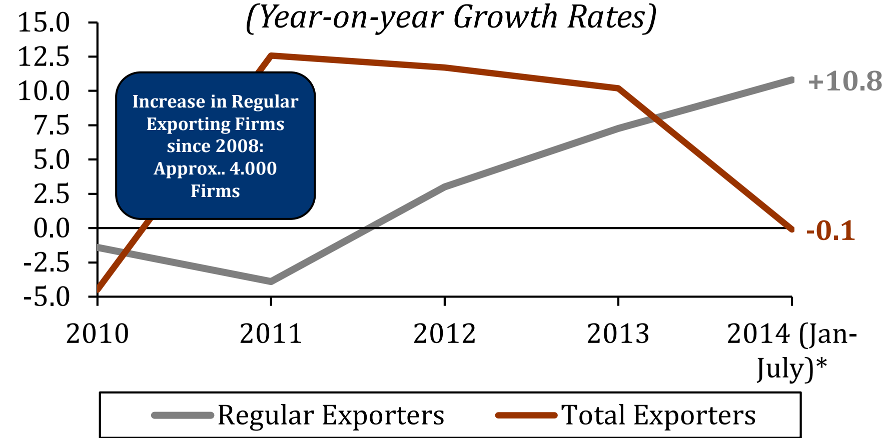
Source: Bank of Spain.
** Up to July 2014*

Data

Recent evolution of the external sector

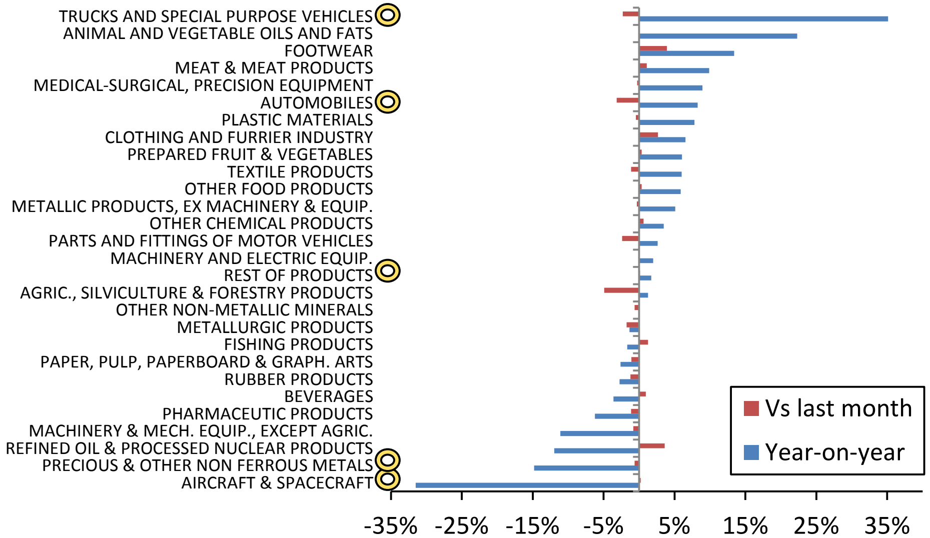
- Recent balance of payments statistics reflect a stabilising trend in exports; to a great extent it is attributable to large ticket orders in 2013 in specific types of goods (Navantia, Mecca-Medina high speed rail project, etc.) while others have continued with the positive trend
- Meanwhile exports of services maintain notable growth rates; exports of construction services are recovering positive growth rates

Exporting Firms
(Year-on-year Growth Rates)

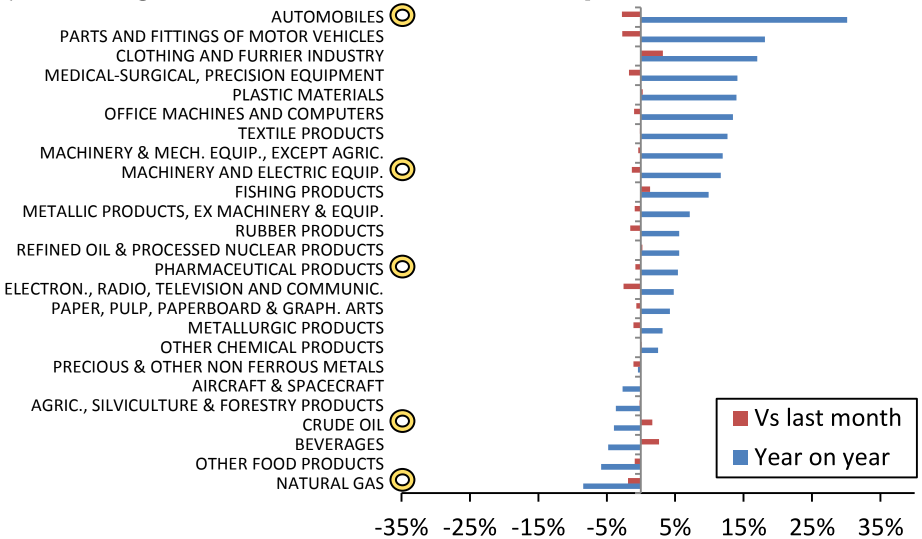


Source: National Statistics Institute. Data

Main Export Products
(With Weight in Total 2013 Merchandise Exports >1%. Smoothed data)



Main Import Products
(With Weight in Total 2013 Merchandise Imports >1%. Smoothed data)



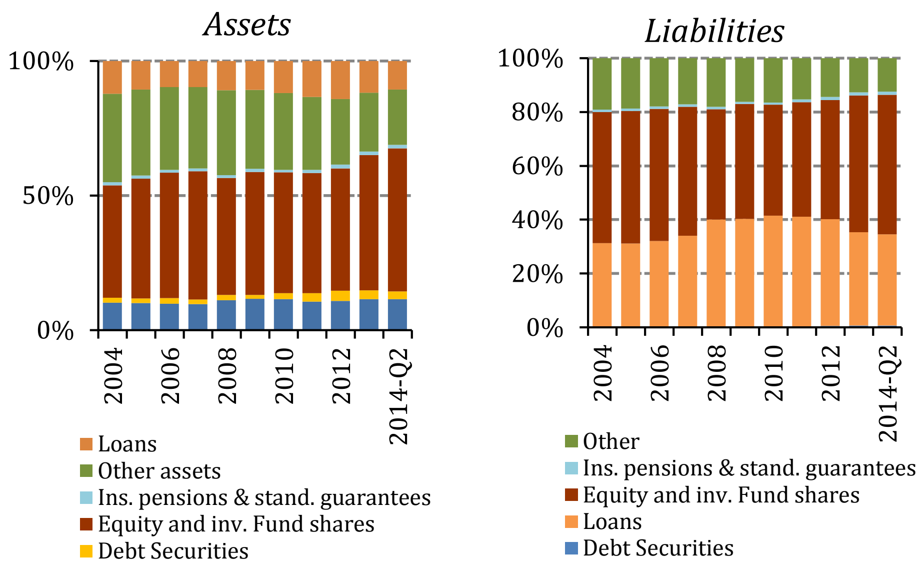
Data

Source: Ministerio de Economía y Competitividad.

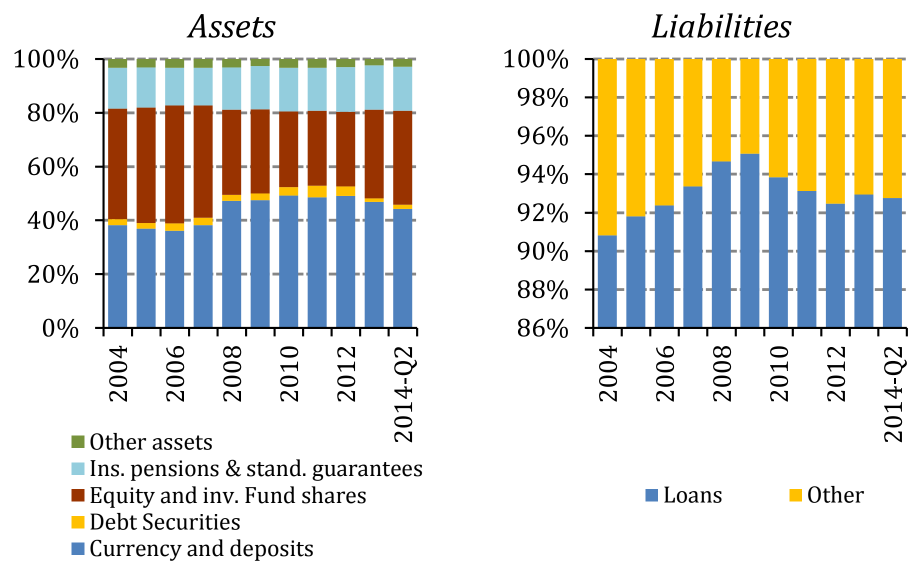
Deleveraging of the private sector: re-composition of assets and liabilities

- 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. This feature will be enhanced through recent structural reforms (Royal Decree on Debt Restructuring & Reform of the Insolvency Regime)
  - 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)



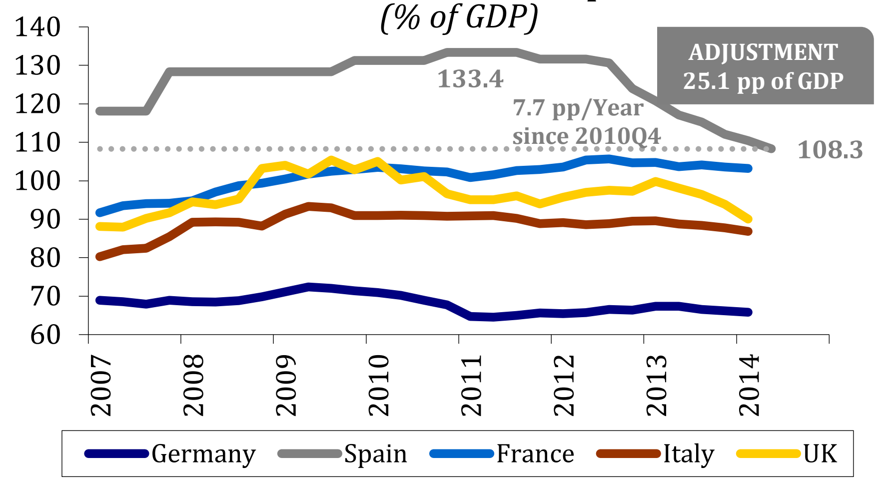
Source: Bank of Spain.

Data

Deleveraging of the private sector: non-financial corporations

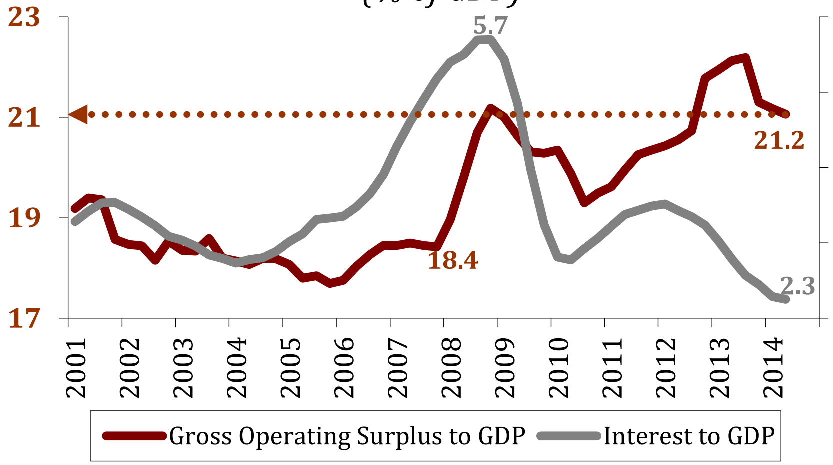
- Non-financial firms reduced their debt stock by c.25% of GDP. Firms generating savings and concentrated on reducing debt
  - Gross operating surplus of non-financial corporations has increased form below 18% of GDP to above 21% in 6 years
  - Strong flow correction: indebtedness excl. equity to Gross Operating Surplus and to Gross Disposable income below 2002 levels

Debt of Non-Financial Corporations
(% of GDP)



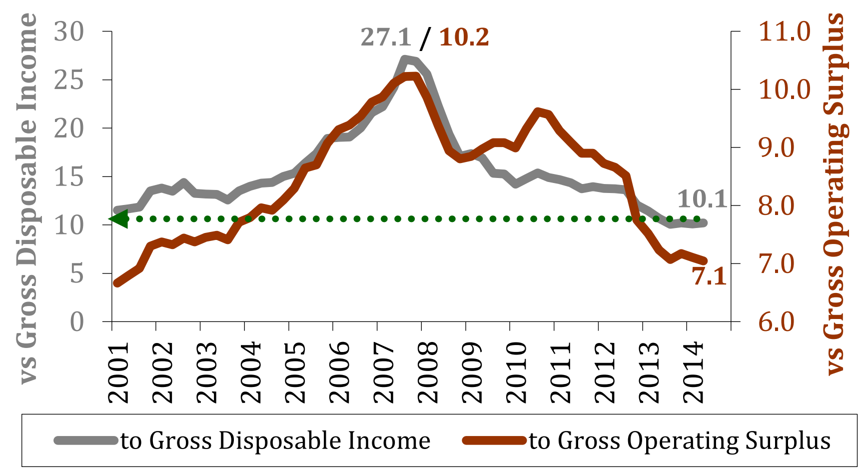
Source: ECB & Bank of Spain. ESA-2010 data for Spain. Data

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



Source: National Statistics Institute. Data

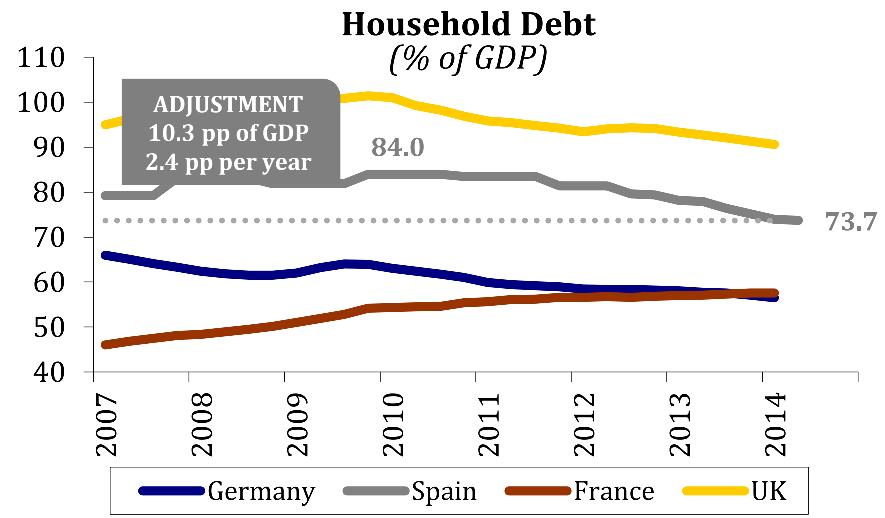
Non-Financial Corporations. Liabilities Excl. Equity to Gross Disposable Income and Gross Operating Surplus



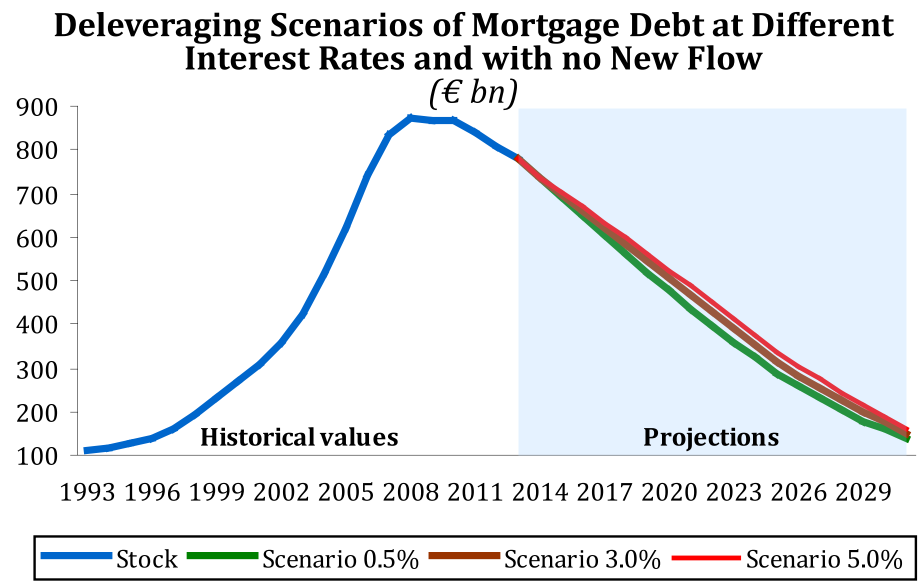
Source: National Statistics Institute and Bank of Spain. Data

Deleveraging of the private sector: households

- Households have progressively reduced their leverage ratios and their debt is below 2007 levels
  - Debt/GDP of Spanish households has declined from 84.0% in 2010Q4 to 73.7% by 2014Q2
- Projections of existing mortgage debt amortisation schedules point in the direction of a fast deleveraging process
  - By 2018 the Household Debt/GDP ratio will 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 & Bank of Spain. ESA-2010 data for Spain. Data

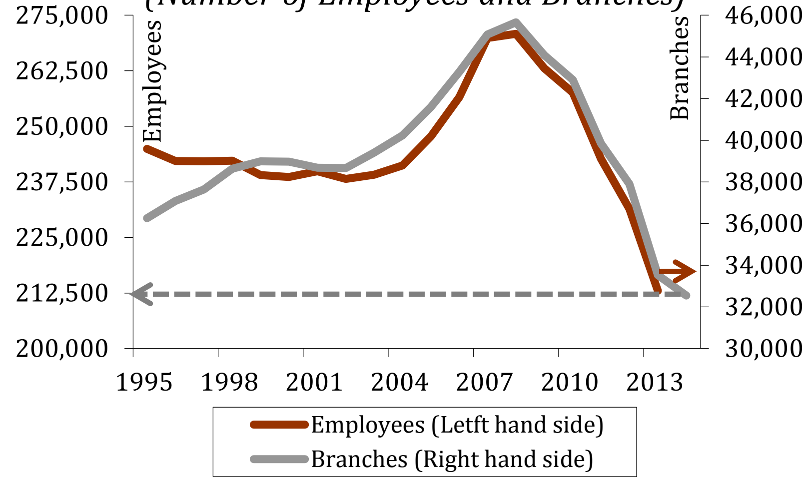


Source: Santander GBM Research.

Adjustment and recapitalisation of the financial system (I)

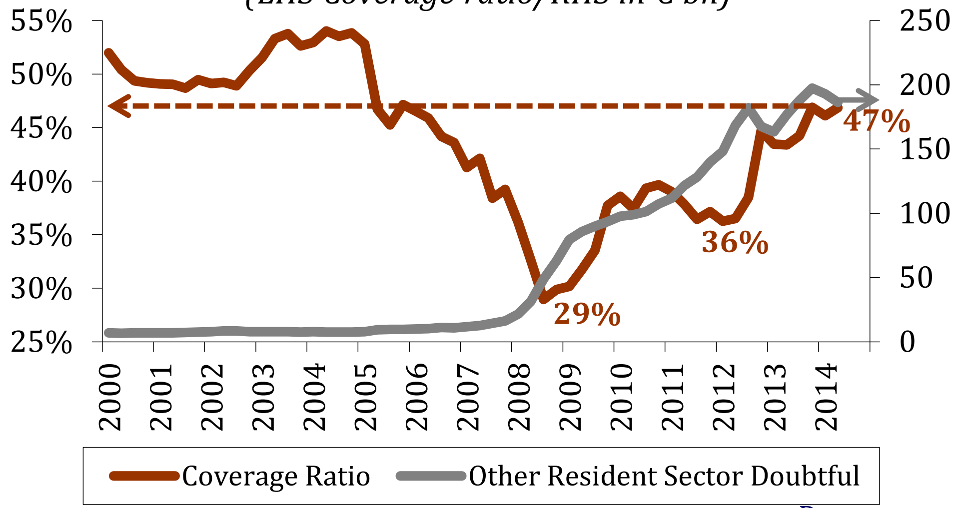
- The winding-down of the financial sector has removed the excess capacity built up during the housing boom
- Capital increases and voluntary liability management exercises in the last 4 years above €100 bn:
  - ❑ FROB and Deposit Guarantee Fund: €59 bn
  - ❑ Burden-sharing exercises: €13.6 bn
  - ❑ 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)

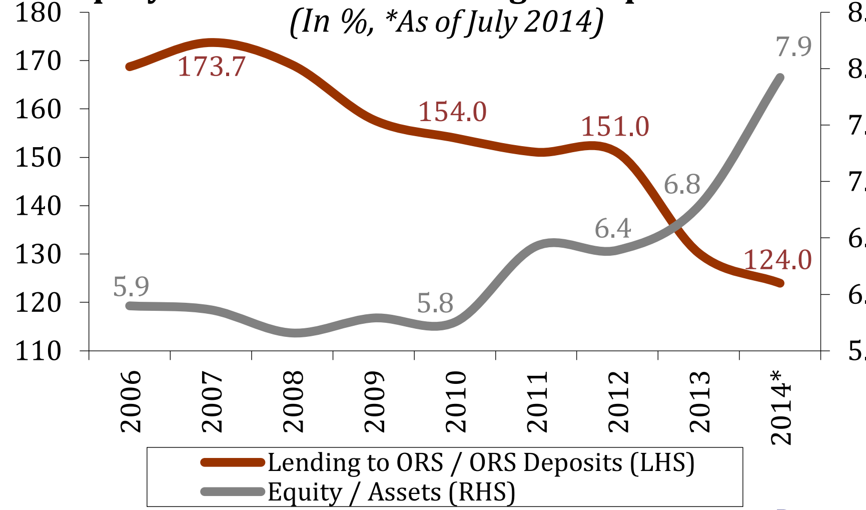


Source: Bank of Spain. Data

Adjustment and recapitalisation of the financial system (II)

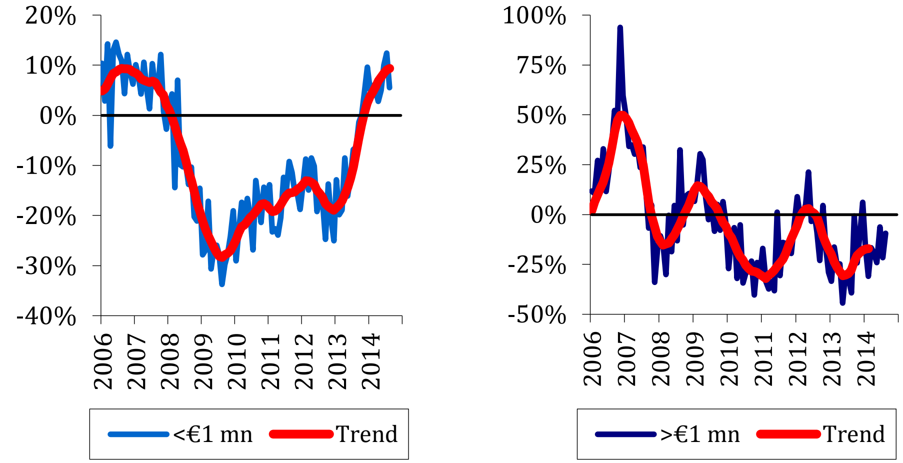
- Capitalisation of the financial sector: equity-to-asset ratio of the overall sector has increased from 5.8 in 2010 to 7.9 up to July 2014
- Closing the funding gap: the lending-to-deposits ratio has declined from 154% in 2010 to 124.0% on average in 2014 (121.6% in July 2014)
- In line with improving credit standards, credit to non-financial firms is beginning to improve, especially so in the case of credits below €1 mn

Equity-to-Assets and Lending-to-Deposits Ratios
*(In %, *As of July 2014)*



Source: Bank of Spain. Data

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

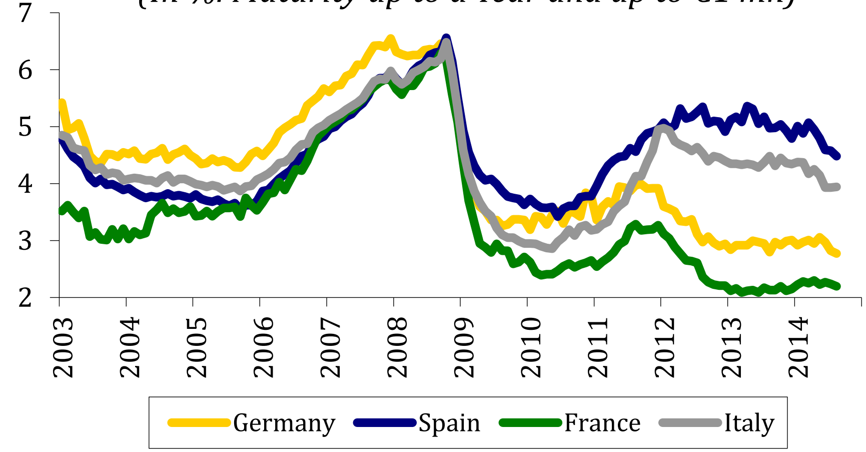


Source: Bank of Spain. Data

Credit developments bolstered by progress in European Banking 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

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

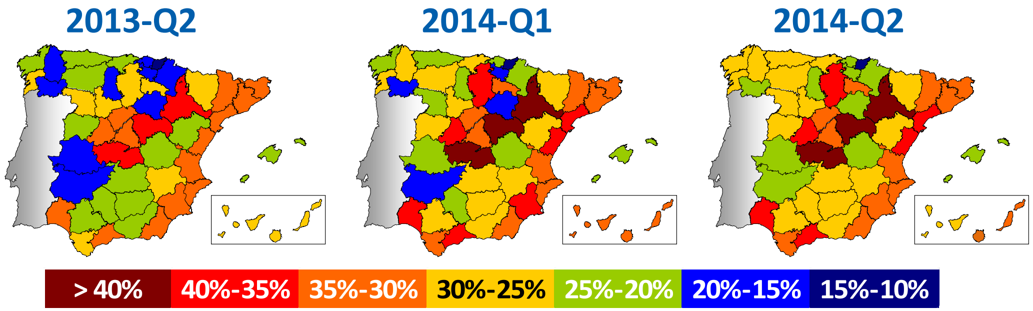


Source: European Central Bank. Data

The construction sector has accelerated its adjustment

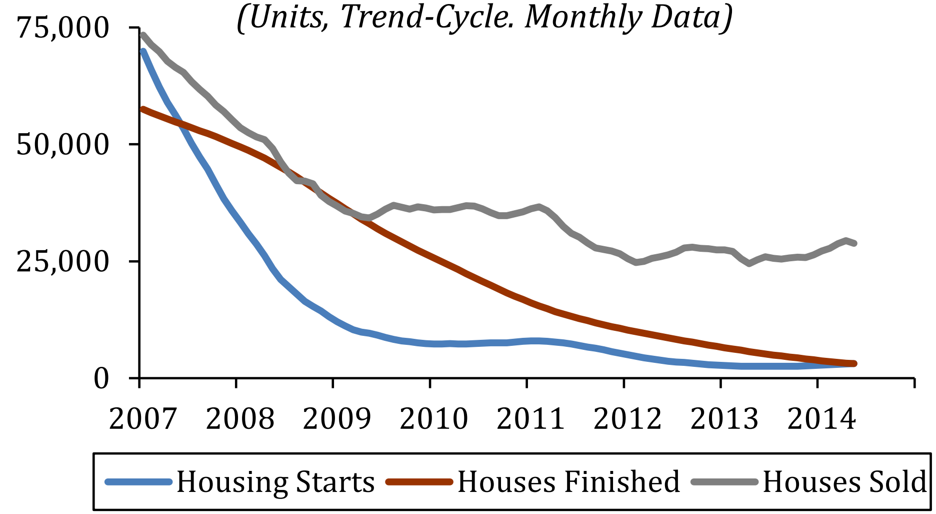
- Real estate prices have fallen on average by approx. 30% in nominal terms since the peak in 2008
- Recent data point towards milder declines around coastal areas and increased adjustment in the inner provinces
- The adjustment has been very heterogeneous and more intense around most populated and coastal 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. Spanish Economic Policy

2. Transformation of Spain’s Growth Model

3. The Funding Programme of the Spanish Treasury

The Treasury's Revised Funding Programme for 2014

- In line with fiscal consolidation strategy for 2014, the net funding in the Treasury's Funding Programme for 2014 was revised downwards by €10 bn,
- Up to October 16th the Spanish Treasury has funded €121.2 bn of the expected amount of the regular medium- and long-term gross issuance
- Including Letras, the Spanish Treasury has issued €199.9 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

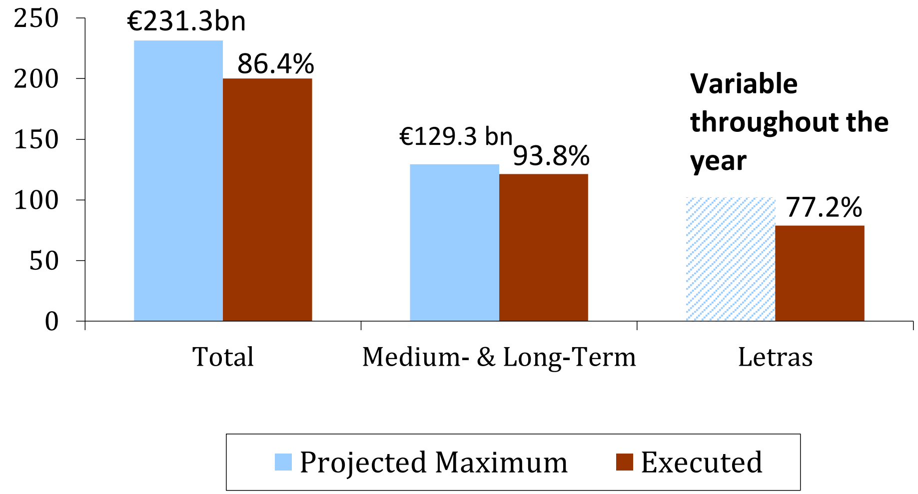
1 Redemptions of Letras, and therefore also gross issuance, will depend on the Letras issuance stra tegy in 2014

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, October 16th 2014)

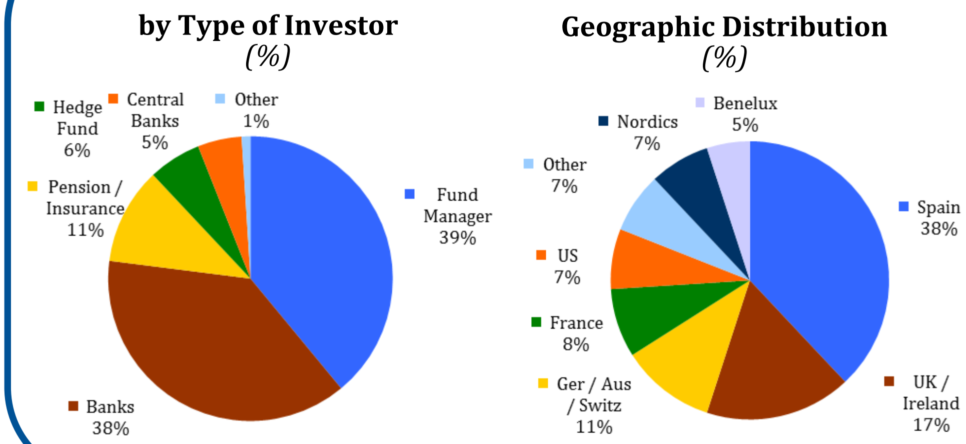


Source: Secretaría General del Tesoro y Política Financiera. Data

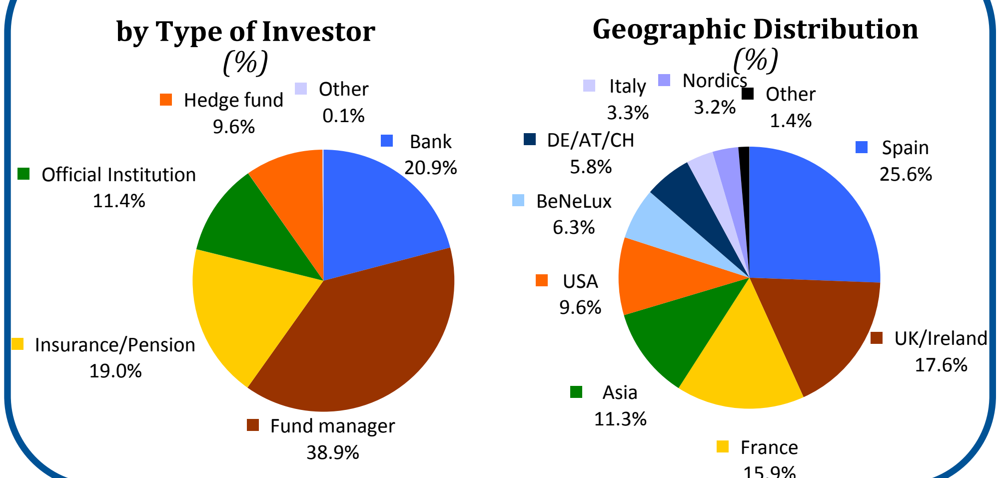
Syndicated issuance in 2014

- 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 2.75% coupon and was priced at a spread of 118 bps over mid swaps
- In October 2014 the Kingdom of Spain issued through syndication its second bond indexed to Euro Area HICP Ex-Tobacco
- Due 30 November 2019, the EUR 5bn 5-year benchmark issue carries a 0.55% annual coupon and was priced at a spread of 69 bps through the nominal bond with coupon 4.3% due October 2019

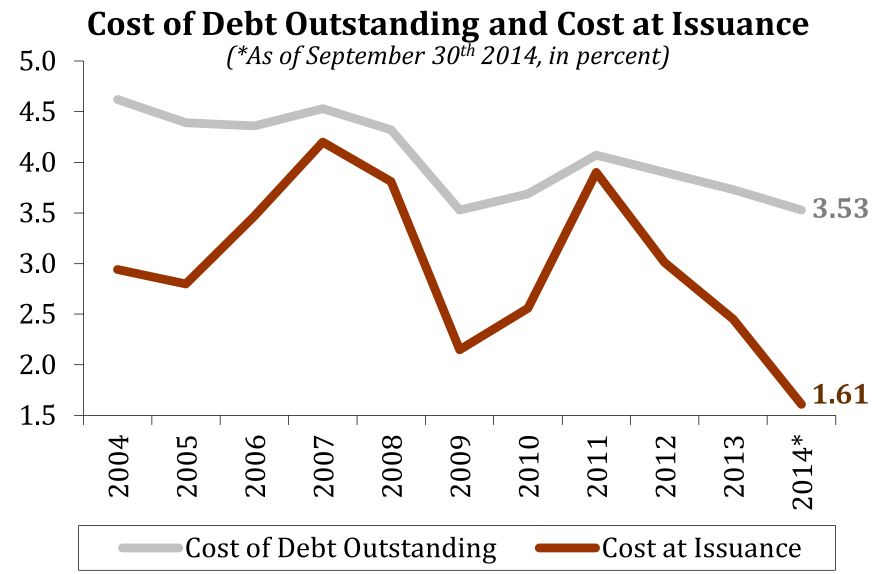
JUNE - NEW 10 YEAR REFERENCE. OCTOBER 2024 CASH BOOK

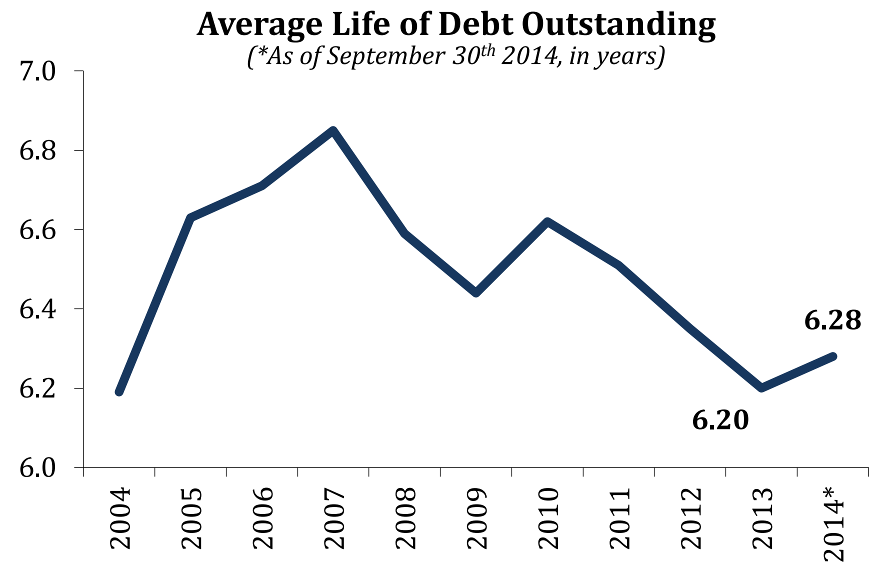


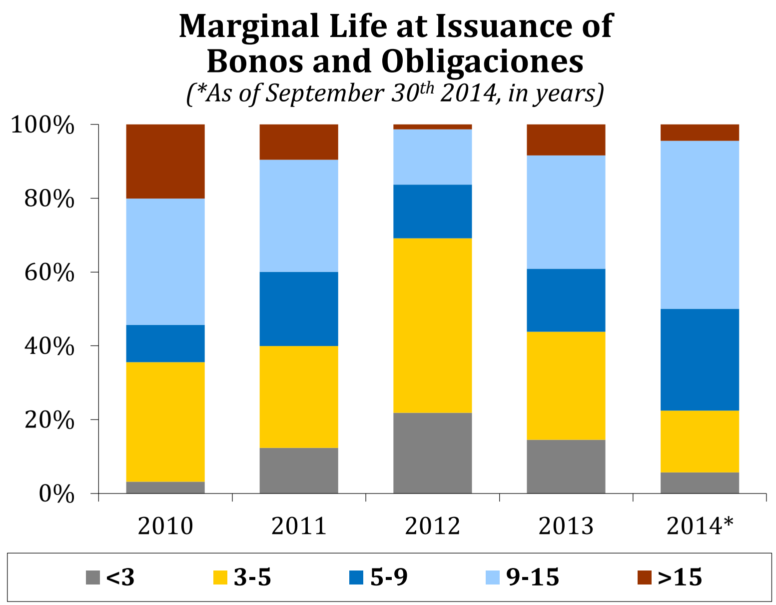
OCTOBER - NEW 5 YEAR BOND LINKED TO EA HICP EX. TOBACCO. NOVEMBER 2019

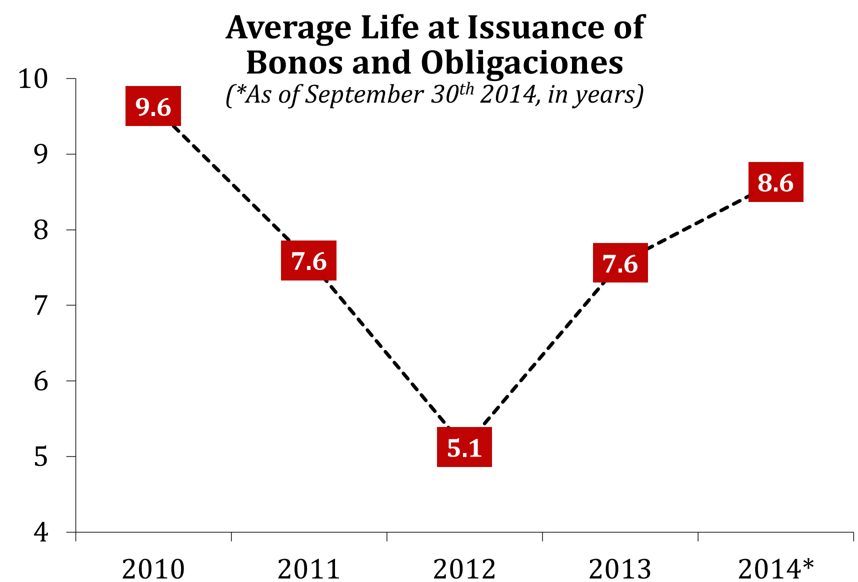


Cost and life of debt



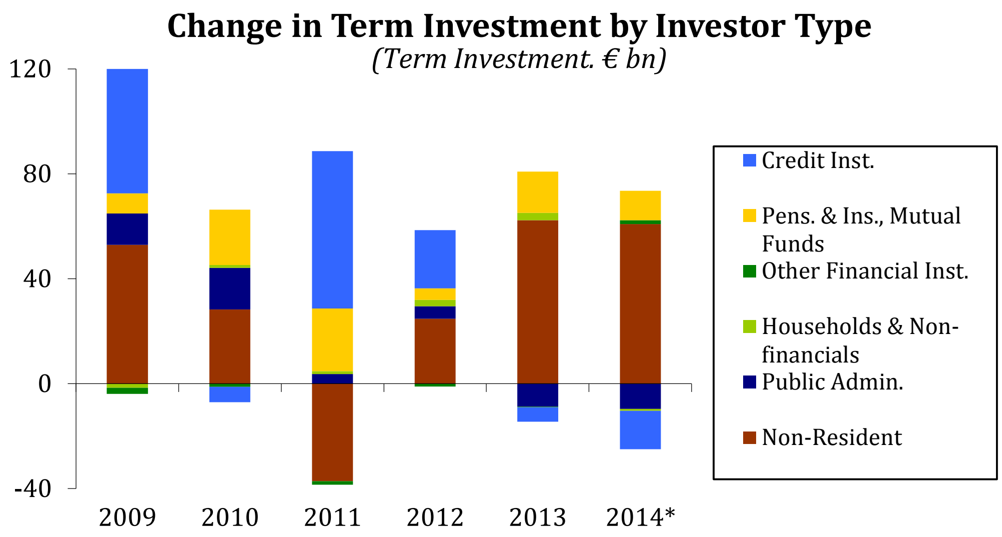






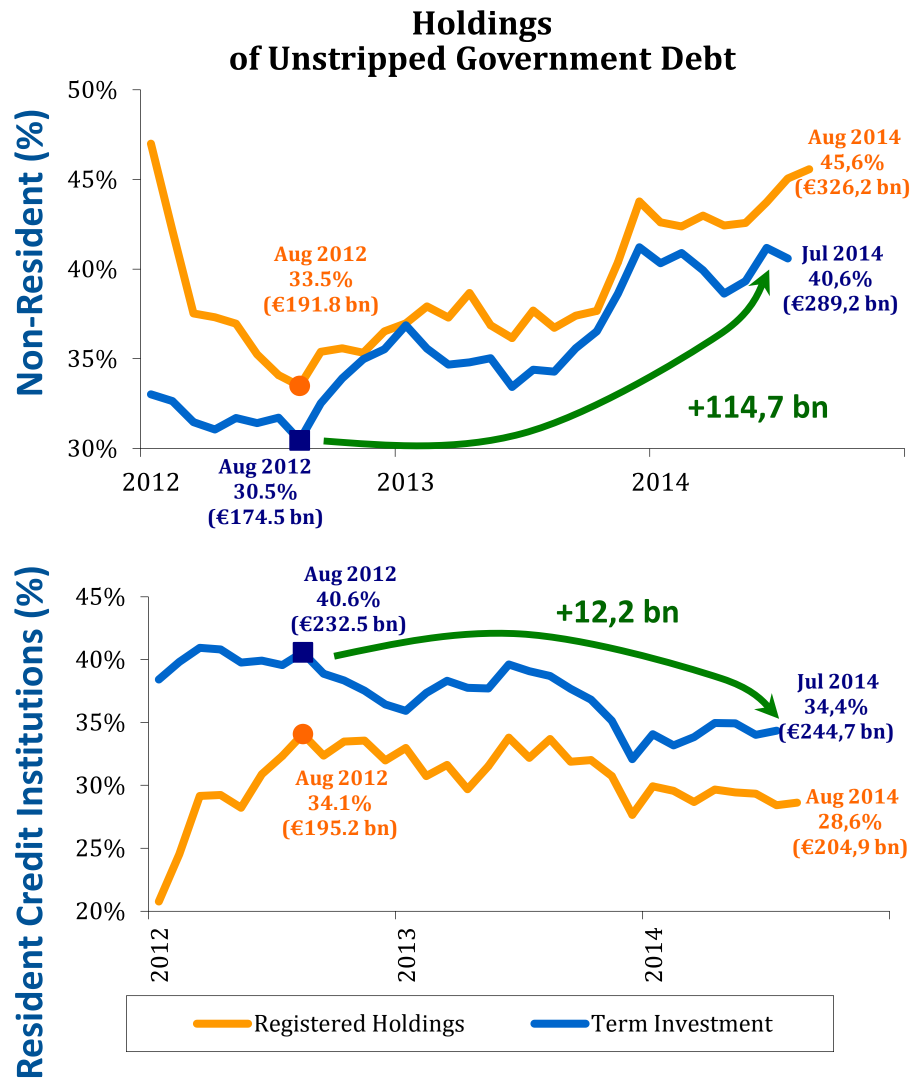
Source: Secretaría General del Tesoro y Política Financiera. Data

Recent trends in investor base



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

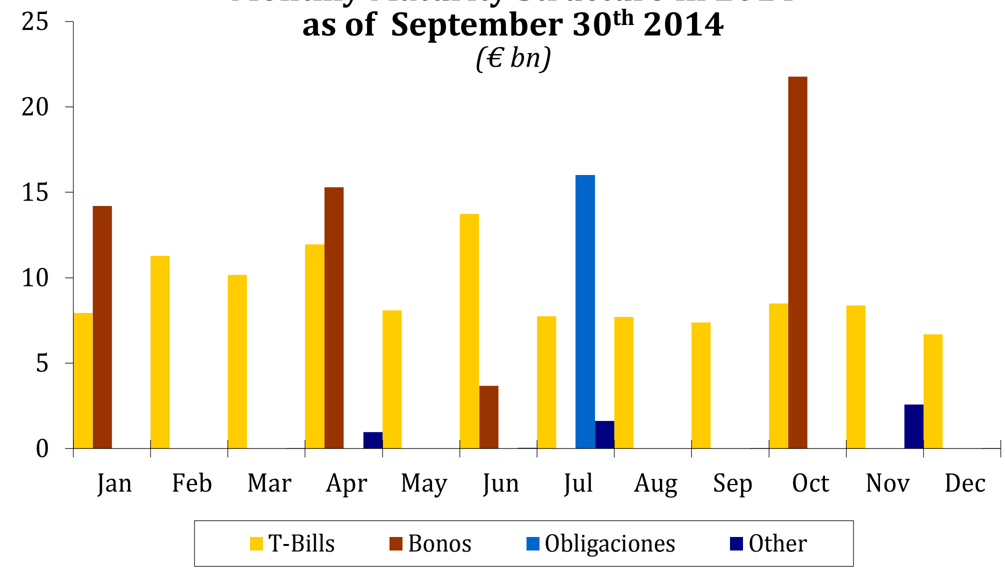
Data



Prudent debt management

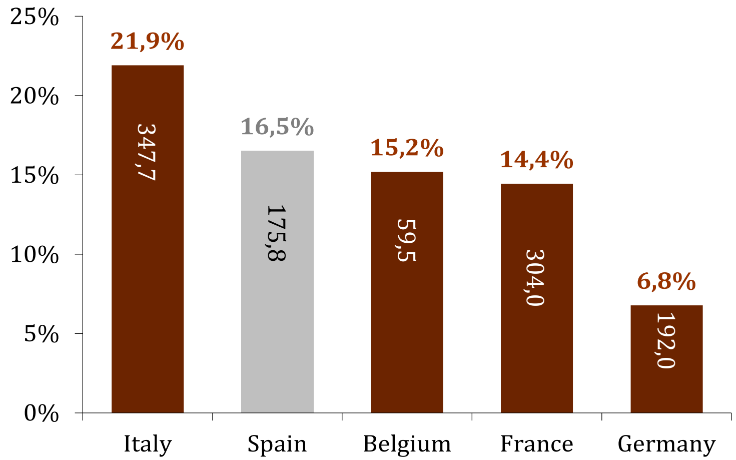
- Redemption dates of medium- and long-term bonds (mainly January, April, July and October) are accommodated to match the dates of biggest inflows of tax revenues
- Excess liquidity is lent in the money market each month through weekly, bi-monthly and monthly repo auctions

Monthly Maturity Structure in 2014 as of September 30th 2014
(€ bn)



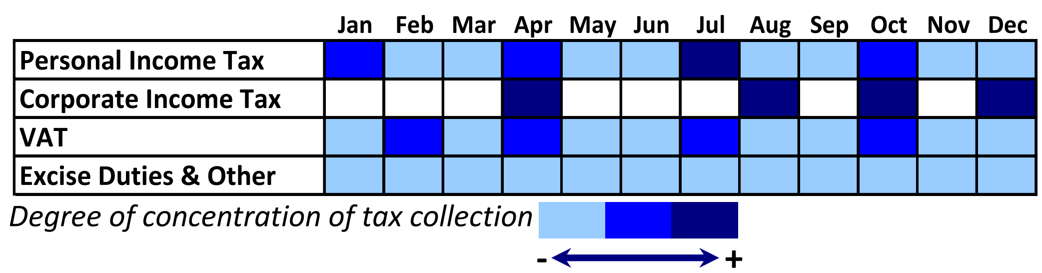
Source: Secretaría General del Tesoro y Política Financiera. Data

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



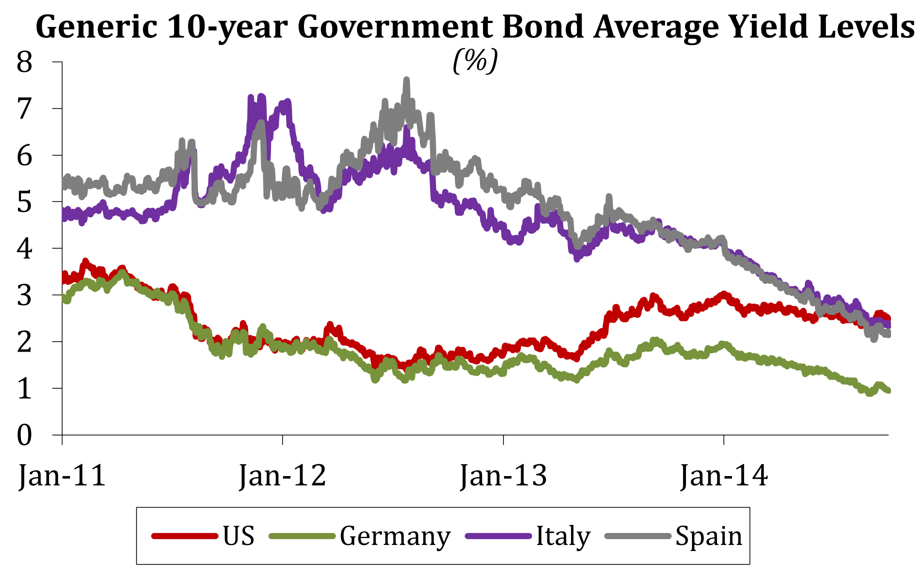
Sources: Secretaría General del Tesoro y Política Financiera for Spain, August 31st data for Italy, and Bloomberg for other countries. Data

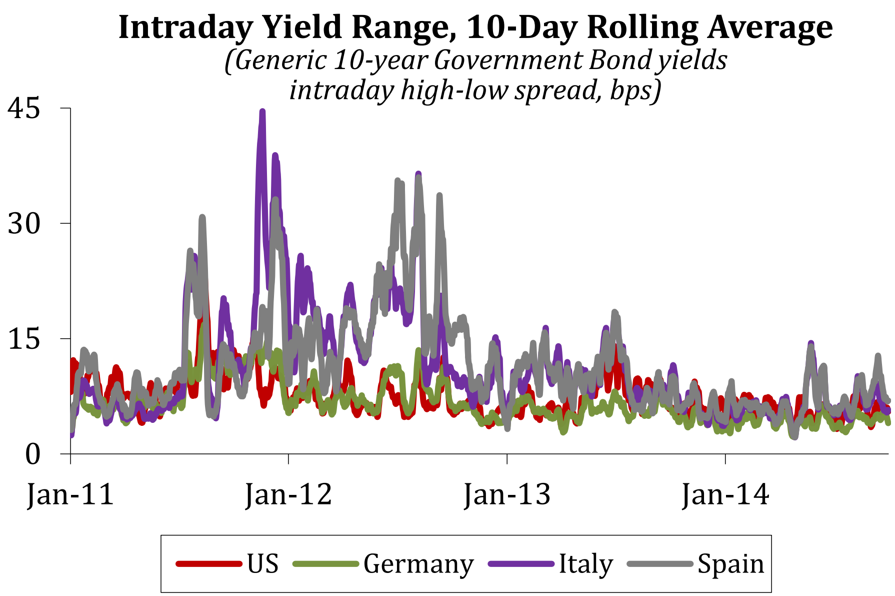
Administrative Distribution of Tax Collection

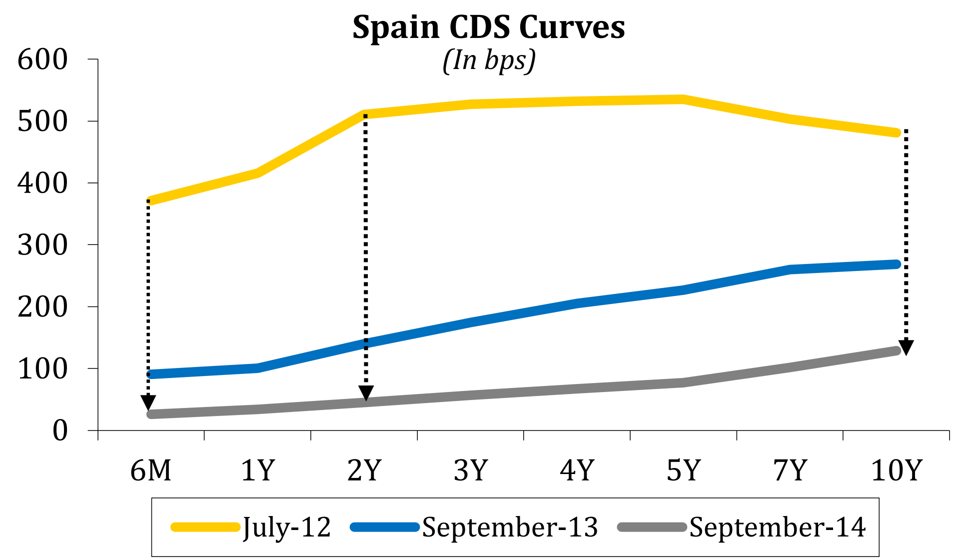


Interest rate volatility has diminished

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



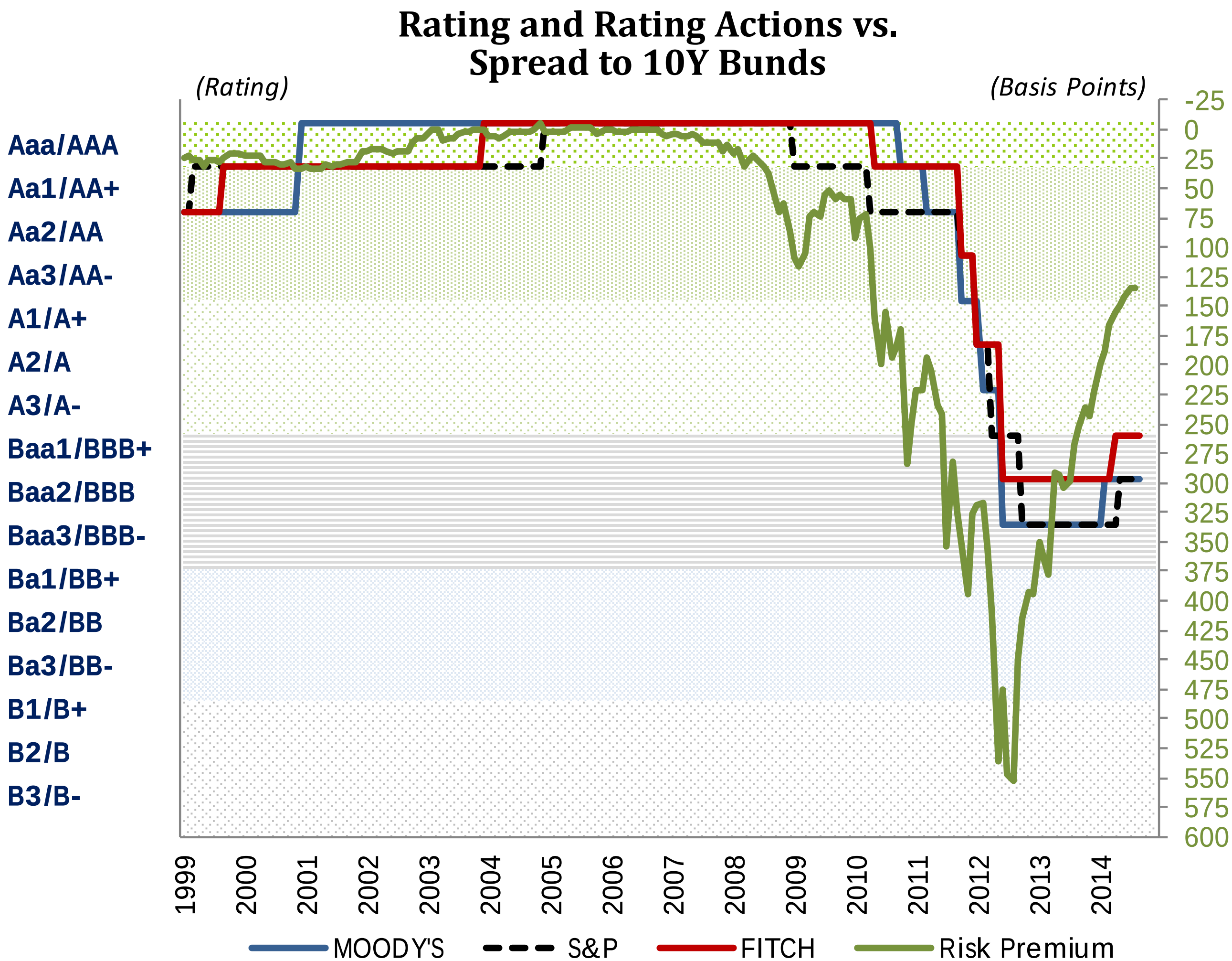




Source: Bloomberg.

Data

Evolution of Ratings



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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