



Economic Policy Strategy and Funding Programme

December 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	-1.2	1.3	2.0
GDP - EC Autumn Forecast (Nov. 2014)	..	1.2	1.7
GDP - IMF WEO (Oct. 2014)	..	1.3	1.7
GDP - OECD (Nov. 2014)	..	1.3	1.7
GDP - FUNCAS Forecast panel (Nov. 2014)	..	1.3	2.0

Other macroeconomic variables			
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

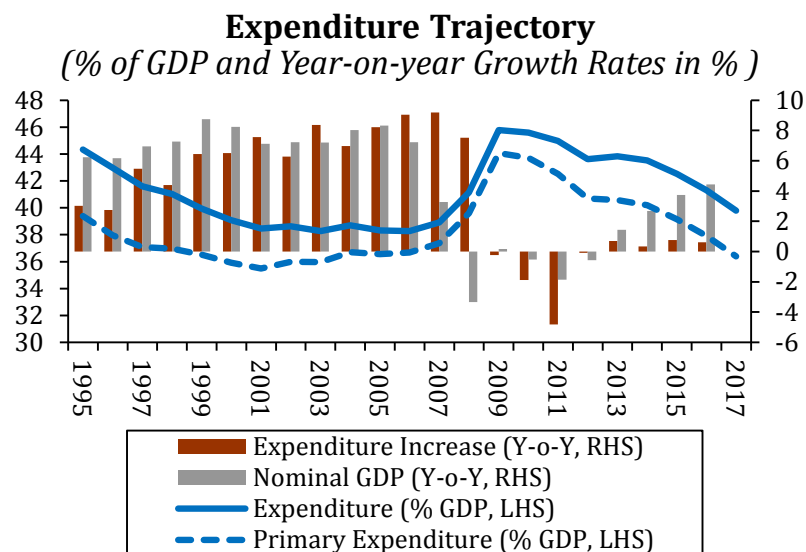
Underlying assumptions		
	2014(f)	2015(f)
Short-term interest (3m Euribor rate)	0.2	0.2
Long-term interest (sovereign 10y debt)	2.8	2.6
USD/€ exchange rate	1.35	1.30
World GDP growth	3.3	3.9
Euro Area GDP growth	0.9	1.6
Oil prices (Brent, USD/barrel)	106.2	104.1

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
- ▶ Building up on efficiency reforms (CORA Measures) and the reform of the Public Administrations

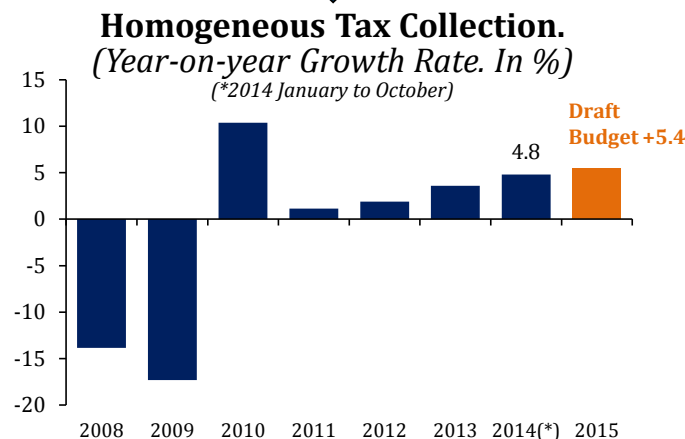


Source: Ministerio de Hacienda y Administraciones Públicas.

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 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](#)

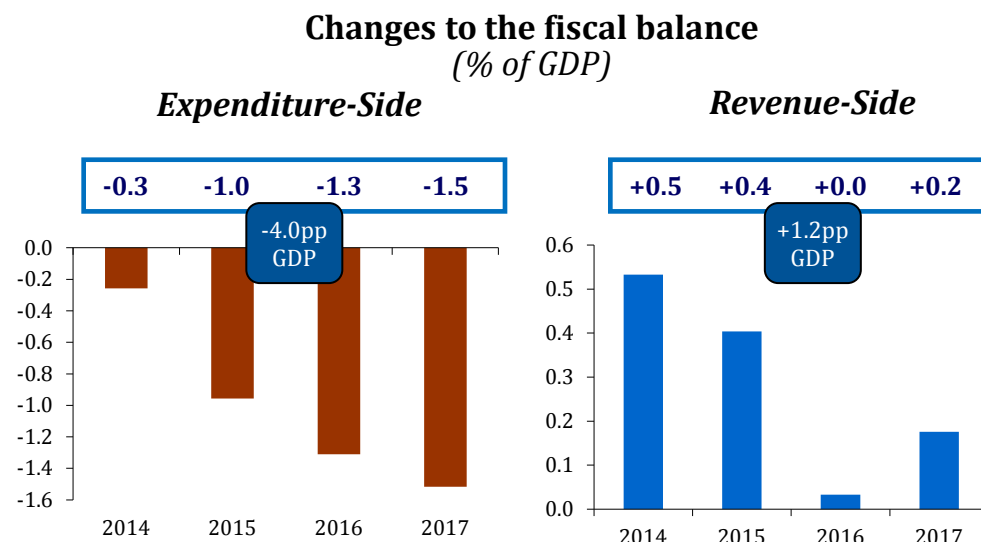
The fiscal path of the Public Administrations 2014-2017

- ▶ 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.

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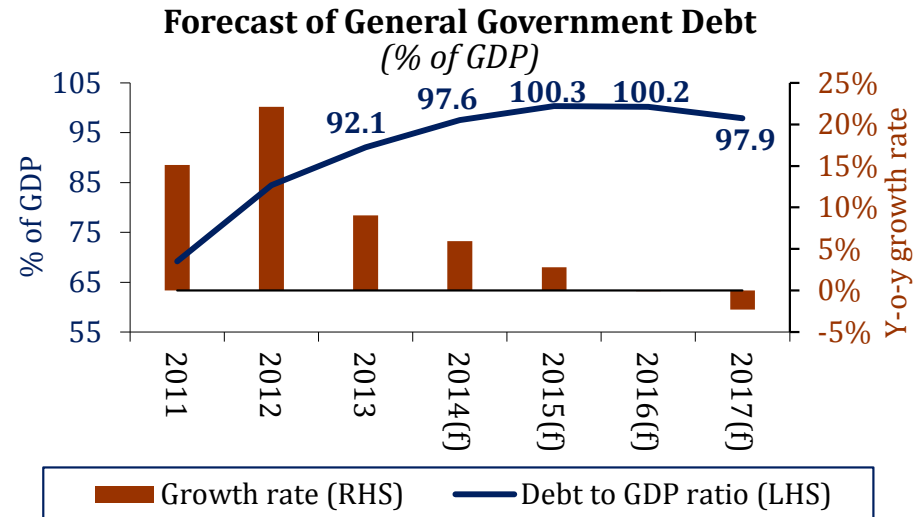


Source: Ministerio de Economía y Competitividad.

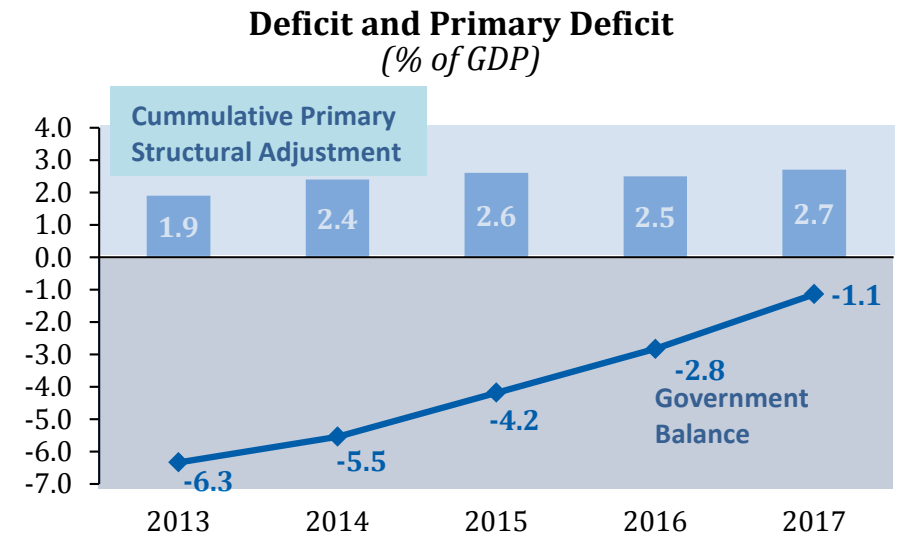
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Debt/GDP dynamics 2014-2015

- ▶ Debt to GDP ratio to peak above 100% of in 2015
- ▶ Primary surplus to be reached in 2016, reversing the Debt to GDP trajectory
- ▶ Lower structural deficit in 2017, ensures the decline in the ratio and reinforces the downward trend
- ▶ Impact stemming from one-off components has almost disappeared (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:

❑ Central Government (September 2014 data): the combined deficit of the Central Government Administration and the autonomous entities of the Central Govt. reached €30.6 bn

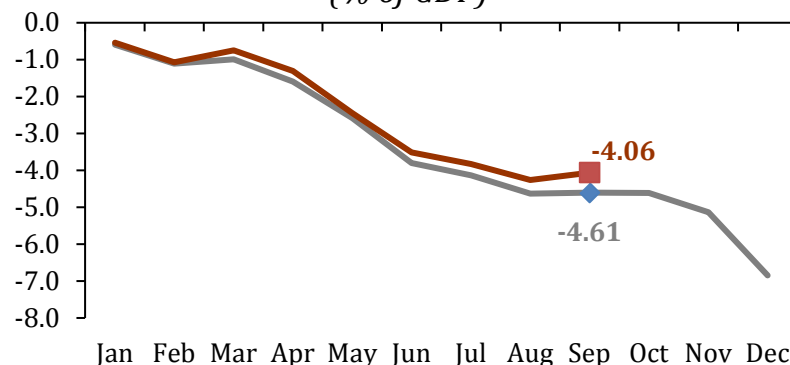
▪ Central Gov. Administration (October 2014 data): deficit €30.9 bn vs. €36.5 bn in October 2013; primary deficit down to €5.9bn vs. €12.8 bn in October 2013

- ✓ Revenue increased by 4.5% y-o-y
- ✓ Expenditure increased by 0.4% y-o-y

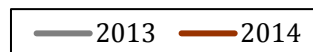
❑ Regional Governments (September 2014 data): deficit reached €12.4 bn

❑ Social Security Administrations (September 2014 data): the Social Security posted a deficit of €0.2 bn

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

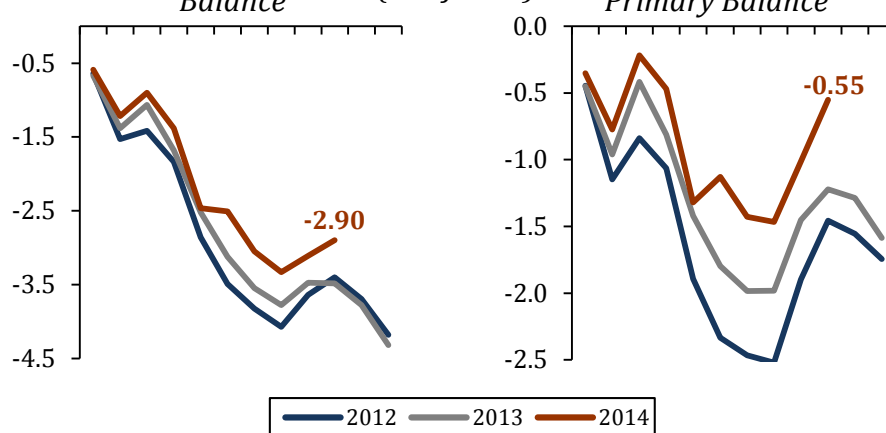


Source: IGAE.

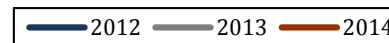


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Breakdown of the Budget Balance of the Central Government Administration Excl. Financial Sector Recapitalisation (% of GDP)



Source: IGAE. Up to September 2014



Data

STRUCTURAL REFORMS

The reform process continues

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 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

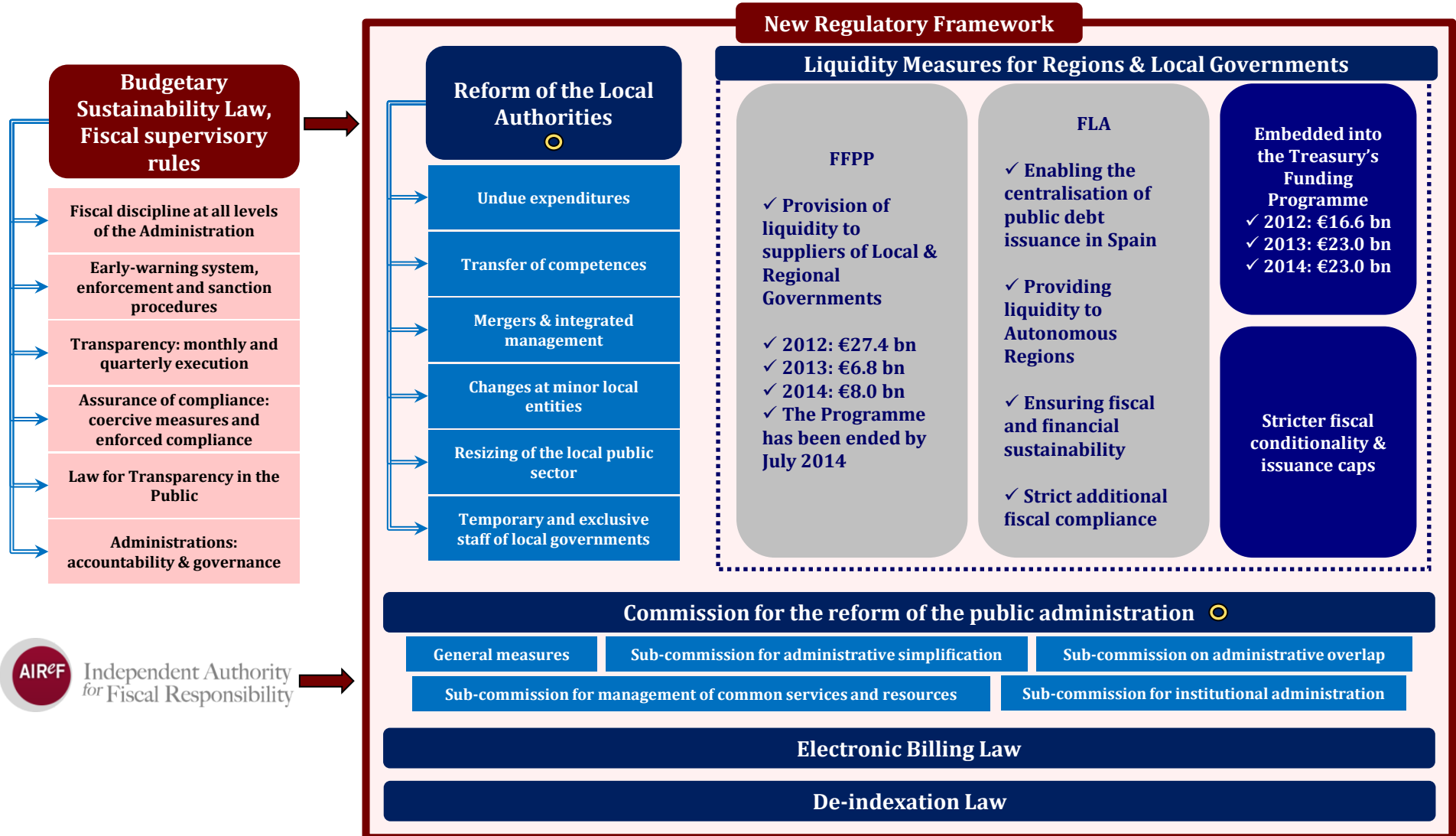
- Economic Structural Reforms
- Public Sector Reforms
- Financial Sector Reforms

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



The reform of the public administrations (II)

- ▶ A highly devolved system of regional and local competencies, more than elsewhere in Europe
- ▶ Together with the resources provided by the Regional Financing System, regions have access to region-specific taxes, transfers from the General State Budgets, EU Funds...
- ▶ Since 2012 two auxiliary Funds were established by the Central Government → FLA and FFPP
- ▶ “Fund to Finance Supplier Payments” aimed at paying the territorial administrations (both regions and municipalities) for outstanding invoices and, hence, regularising the arrears. This Fund has been extinguished in July 2014. The outstanding debt has been assumed by the Spanish Treasury
- ▶ “Regional Liquidity Fund” created to provide to Spanish Regions the needed liquidity to cover redemptions in capital markets as well as the authorised deficit

	Spain	Austria	Germany	Italy	Italy	France	Belgium
	17 Autonomous Communities	9 Bundesländer	16 Bundesländer	5 Special Statute Regions	15 Regions Ordinary Statute	26 Regions	3 Regions 2 Com. Ling
Education	✓	✓	✓	✓		✓	✓
Health	✓	✓	✓	✓	✓		✓
Transport	✓	✓	✓	✓	✓	✓	
Economy	✓	✓	✓	✓	✓	✓	
Justice	✓	✓	✓				
Universities	✓		✓				
Police	✓		✓				
Infrastructures	✓	✓	✓	✓			
Environment	✓	✓		✓		✓	
Housing	✓	✓		✓	✓		
Local Entities	✓	✓		✓			
Culture	✓					✓	✓
Tourism	✓					✓	
Employment	✓					✓	
Social Services	✓						

Autonomous Community	FLA (€ mn) (2012-2014f)	FFPP (€ mn)
Andalusia	11,197	4,956
Asturias	783	243
Balearic Islands	2,337	1,344
Canary Islands	2,499	315
Cantabria	728	327
Castile - La Mancha	3,425	4,026
Catalonia	24,734	6,556
Murcia	2,278	1,791
Valencia	12,102	7,586
Aragon		513
Castile and Leon		1,052
Extremadura		392
Galicia		0
La Rioja		71
Madrid		1,347
TOTAL	60,084	30,518

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

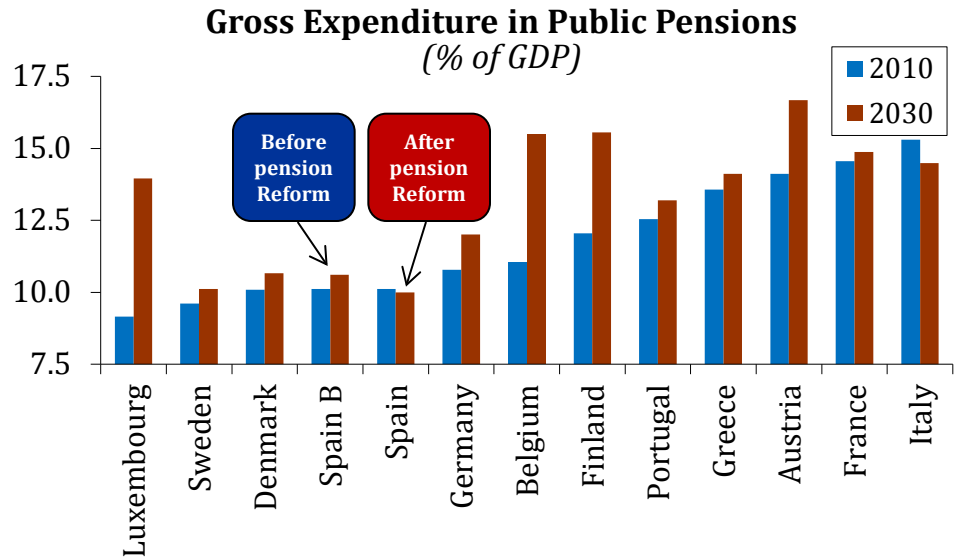
Changes to Personal Income Tax	Changes to Tax on Capital	Changes to Corporate Income Tax	VAT	Fight Against Tax Fraud	R&D and cultural investment
▶ Reduction in number of tranches and rates in two years	▶ Lower rates in two years and more progressive	▶ Reduced general rate: from 30% to 25% in two years (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%		Tax audit process: New deadlines and suspension of Statutes of Limitation in specific situations	
▶ Limits to exemptions to severance payments in case of unjustified dismissal	▶ Capital gains generated in less than 12 months no longer penalised	▶ Substitution of deductions in CIT <ul style="list-style-type: none"> ● Deductions eliminated: <ul style="list-style-type: none"> - Environmental investments - Expenses for vocational training - Reinvestment of extraordinary benefits ● New deductions (favouring the deleveraging process): <ul style="list-style-type: none"> - Capitalisation reserves. 10% of corporate income deductible 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) 	▶ 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%.	
▶ Tax deductions for house rental: - Elimination for new rentals (Expenditure side) - Lower tax deductions for house rentals (Income side)	▶ New savings instrument: savings or insurance schemes maintained longer than five years ('Cuenta Ahorro 5'): exempt form capital gains tax	▶ Update and simplification of depreciation tables	▶ Tax assessment cases are extended to smuggling offenses		
▶ 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	▶ New rules on the localisation of assets; taxing at destination of electronic, telecommunications and radio-television services when the addressee is a private individual	▶ Better precision in the indirect assessment regime	▶ 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		▶ Imprescriptibility of the Administration's right to check tax credits derived from statute-barred tax years	
▶ Elimination of abatement coefficients and monetary correction gains		▶ To maintain income from the CIT, in 2015 previous measures maintained		▶ Interruption of the limitation period of related tax obligations	

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



Source: European Commission and Ministerio de Economía y Competitividad

Data

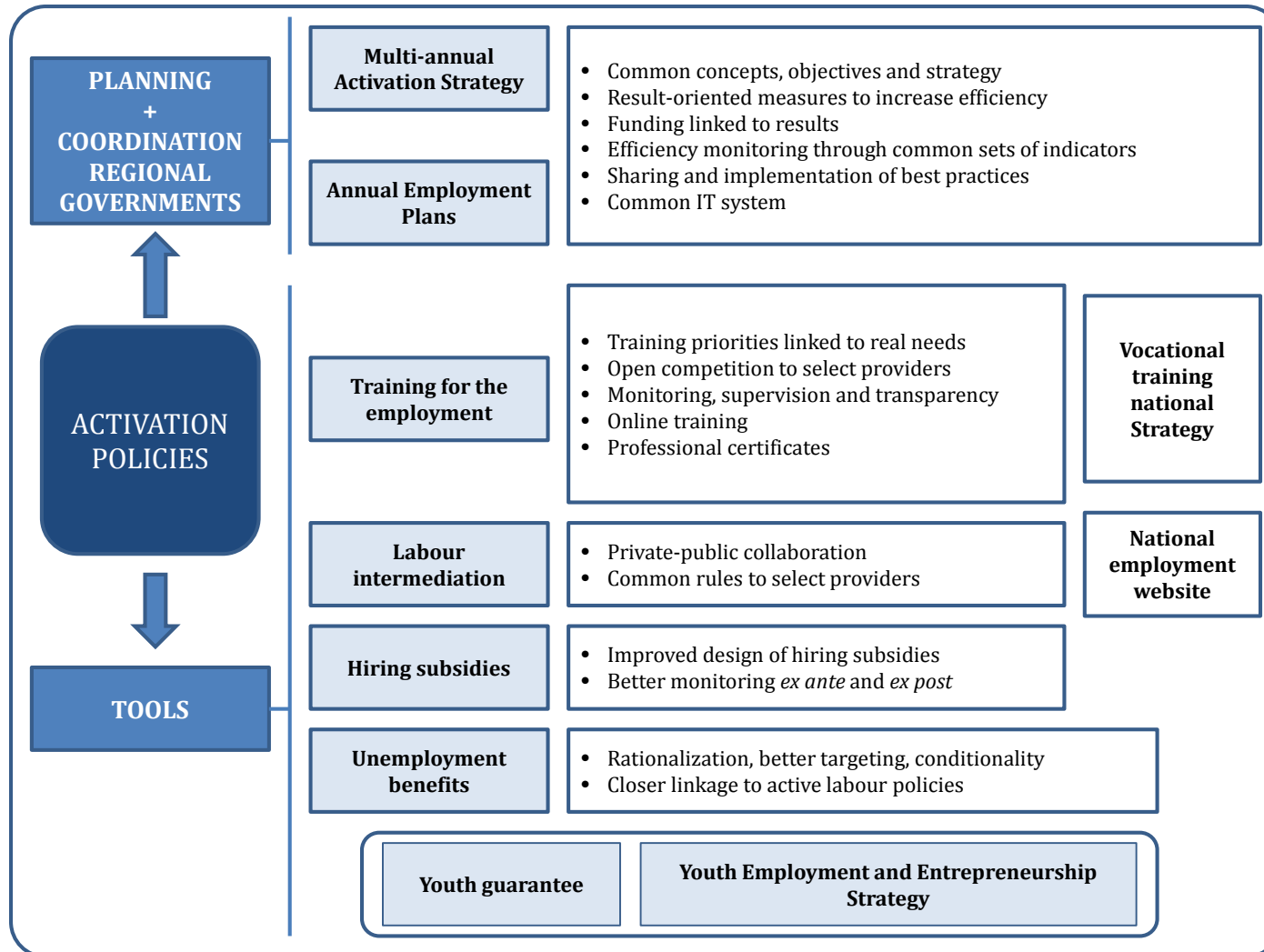
The labour market reform addresses Spain's most important imbalance

► 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"> → Dynamic bargaining more responsive to the needs of businesses and workers 	<ul style="list-style-type: none"> → Avoiding lay-offs: rigidity fostered job cuts as a means of adjusting to economic changes → Lack of flexibility avoided innovation and gains in competitiveness 	<ul style="list-style-type: none"> → Reduction of severance pay for unfair dismissals 	<ul style="list-style-type: none"> 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 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 ③ Flexible regulation of telework ④ Part-time contract: increased flexibility, allowing overtime
<ul style="list-style-type: none"> → Move beyond the model of indexing salaries and wages 	<ul style="list-style-type: none"> → Clear and objective regulatory framework of fair dismissals 	<ul style="list-style-type: none"> → Clear and objective regulatory framework of fair dismissals 	
<ul style="list-style-type: none"> → Balanced regulatory framework in line with economic circumstances 	<ul style="list-style-type: none"> ① Classification of workers based on skills not on professional occupations ② Simplification of rules for the reallocation of workers ③ Streamlining the adoption of significant changes in working conditions ④ Furloughs/Time-reductions if legitimate financial, productive or organisational reasons exist ⑤ Distribution of working-time 	<ul style="list-style-type: none"> ① Severance pay for unfair dismissal down to 33days/Max 24months of salary vs. 45days/Max 42 months ② Clarification of fair dismissal causes (20days/Max 12 Mo) ③ Removal of administrative authorisation for collective layoffs ④ Elimination of procedural salaries ⑤ Fair dismissals for economic causes of civil servants ⑥ Streamlining of dismissals based on absenteeism 	
<ul style="list-style-type: none"> ① Opting out from higher-level agreements ② Priority of company-level agreements ③ Limiting the statutory extension rule of expired agreements up to one year (unlimited before) 			

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.



Financial Sector Reform

► The financial sector reform steps in 2014 address the three main problems of corporate financing: the recovery in financing of viable projects, resolving the dependency on banking credit and reducing the differential cost of Spanish SMEs

Initial steps: 2009-Mid 2013		
2009-2011	FROB I Reform of the Legal Framework of Cajas Integration of Cajas via “Institutional Protection Schemes” and Capital Injections/Asset Protection Schemes	
	FROB II	
2012	Clean-up of Balances (I) €50bn in additional capital and provisions	
	Clean-up of Balances (II) €29 bn in additional provisions to cover possible migrations into NPLs	
	Asset quality review & stress tests	
	Law 9/2012 recovery and resolution of financial institutions	
2013	Recapitalisation & restructuring	Transfer of assets to SAREB for recapitalised banks
	MoU	

End 2013 and 2014	
Law 26/2013 of savings banks and banking foundations	MoU
Law 14/2013 Internationalisation bonds & cedulas: support to exporting entrepreneurs	
RD-Law 11/2014 financial sector solvency and supervision	
Venture capital companies and closed-end collective investment schemes	
Law 17/2014 Reform of the Insolvency regime (I): pre-insolvency proceedings; refinancing and restructuring of corporate debt	
Reform of the Insolvency regime (II): broader scope of insolvency regime & revision of in-court debt restructuring procedures	
Next steps	
Completion of the reform of the savings banks sector: draft circular on savings banks and banking foundations	
Transposition of the Banking Recovery and Resolution Directive & Deposit Guarantee Directive	
SMEs access to finance: draft law promoting corporate financing <ul style="list-style-type: none"> <input type="checkbox"/> Access to banking credit <input type="checkbox"/> Securitisation <input type="checkbox"/> Access to non-bank financing 	

NI

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

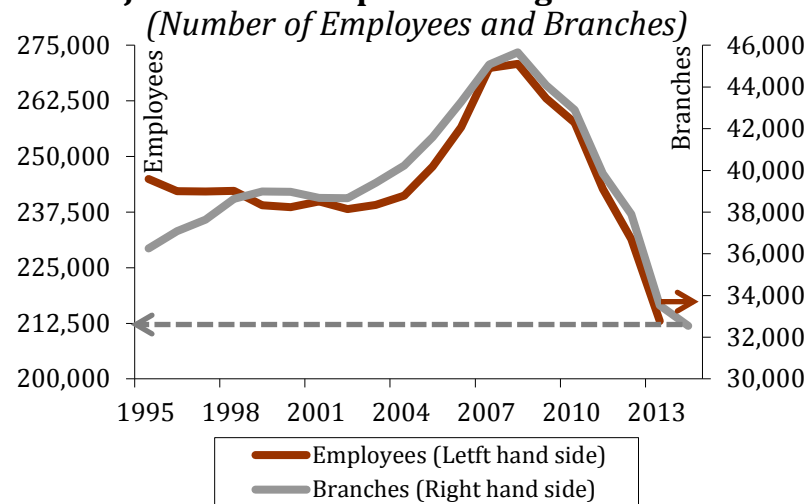
▶ Result:

- 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

Adjustment and recapitalisation of the financial system

- ▶ The winding-down of the financial sector has removed the excess capacity built up during the housing boom
- ▶ Capital increases and voluntary liability management exercises in the last 4 years above €100 bn:
 - ❑ FROB and Deposit Guarantee Fund: €59 bn
 - ❑ Burden-sharing exercises: €13.6 bn
 - ❑ Private capital increases in excess of €25 bn
- ▶ Clean-up effort in the period 2008-2014Q2 amounts to €280 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 47% by 2014Q2

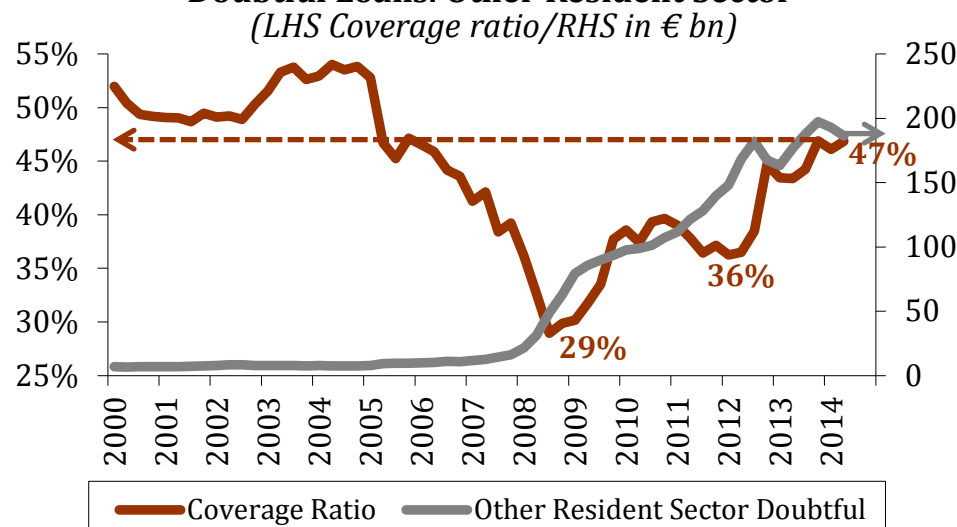
Adjustment in Deposit Taking Institutions



Source: Bank of Spain.

Data

Doubtful Loans. Other Resident Sector

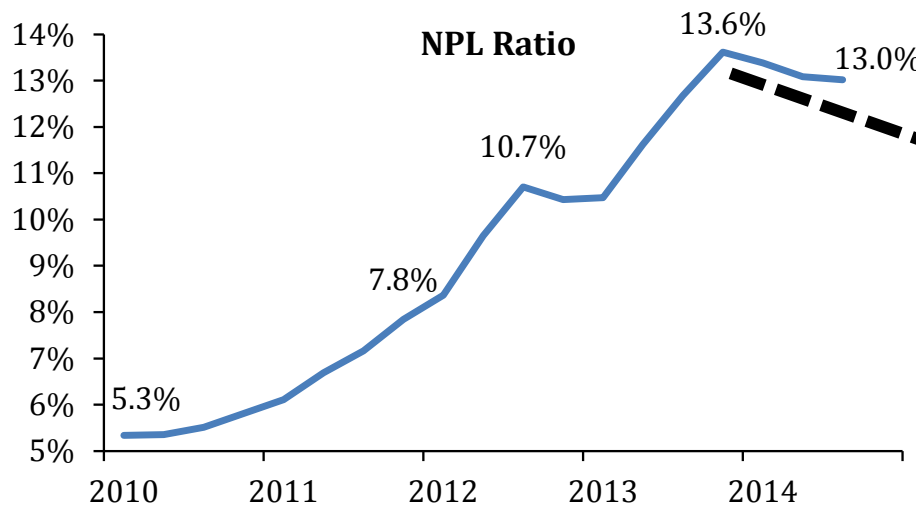


Source: Bank of Spain.

Data

Adjustment and recapitalisation of the financial system (II)

- ▶ 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.
- ▶ In 2014Q3 doubtful have registered their first negative yoy rate since 2004

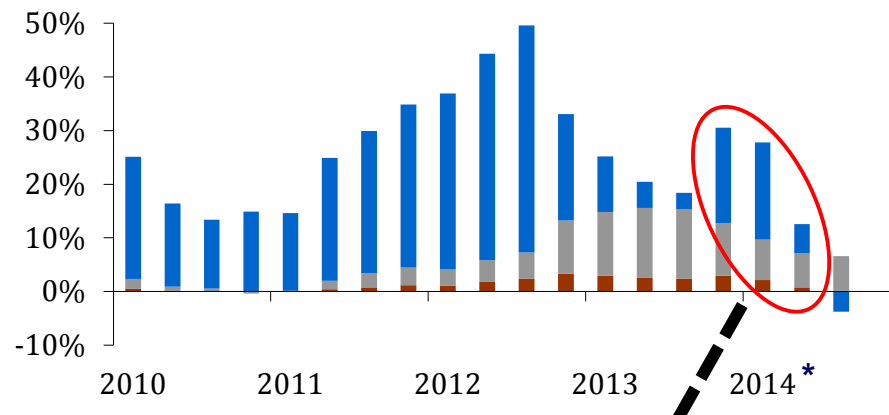


Source: Bank of Spain.

* September 2014 over September 2013

[Data](#)

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



■ Increase in Doubtful loans (Numerator)
■ Fall in total loans (Denominator)
■ Mixed Effects (Not Assignable to Numerator or Denominator)

Source: Bank of Spain.

* Last: August 2014 over August 2013

[Data](#)

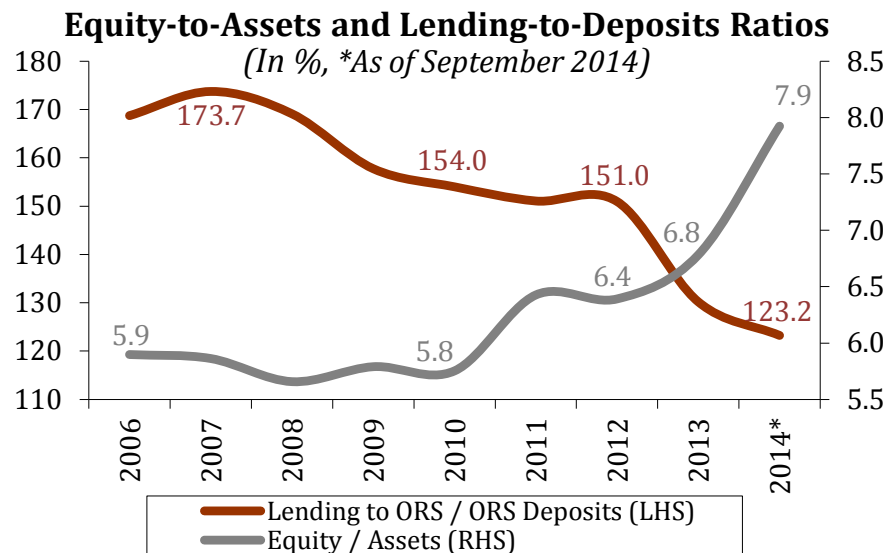
Restructured and Refinanced Loans (€ bn)		
	Initial	After Corrections As of Dec 2013
Normal	73.6	61.7
Sub-standard	37.2	41.0
Doubtful	71.7	108.6

Source: Bank of Spain.

[Data](#)

Adjustment and recapitalisation of the financial system (III)

- ▶ 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 September 2014
- ▶ Closing the funding gap: the lending-to-deposits ratio has declined from 154% in 2010 to 123.2% on average in 2014 (120.8% in September 2014)
- ▶ In line with improving credit standards, credit to smaller non-financial firms is improving, especially so in the case of loans below €1 mn

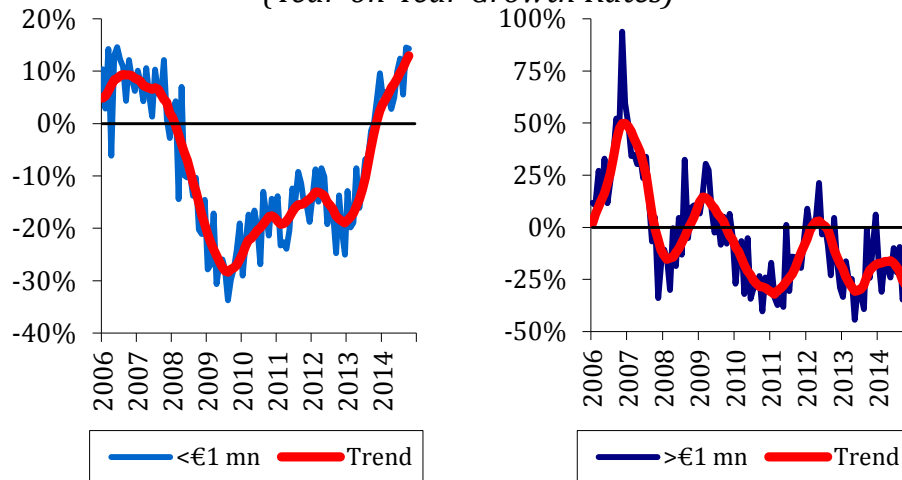


Source: Bank of Spain.

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New Credit to Non-Financial Firms by Size of Loan

(Year-on-Year Growth Rates)

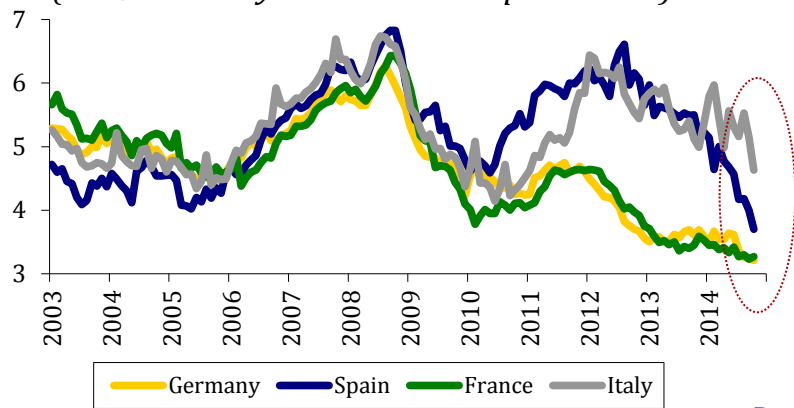


Source: Bank of Spain.

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Lending Rates of New Loans to Non-Financial Corporations

(In %. Maturity 1-5 Years and up to €1 mn)



Source: European Central Bank.

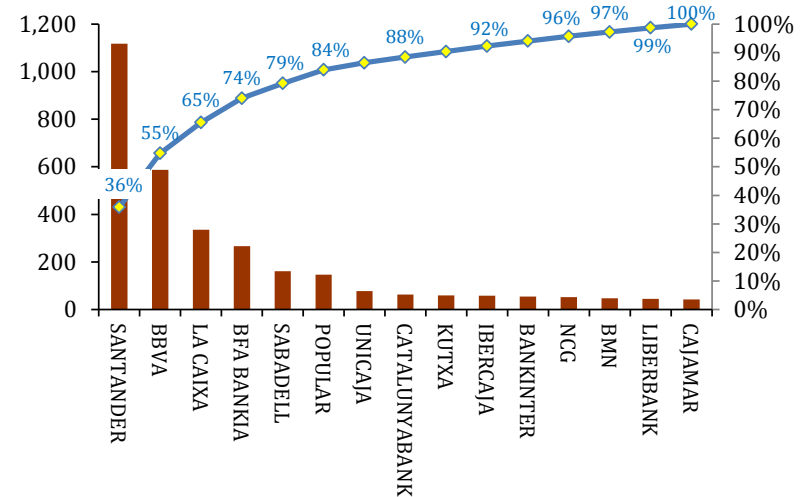
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Spanish Banks: into the Comprehensive Assessment of the ECB

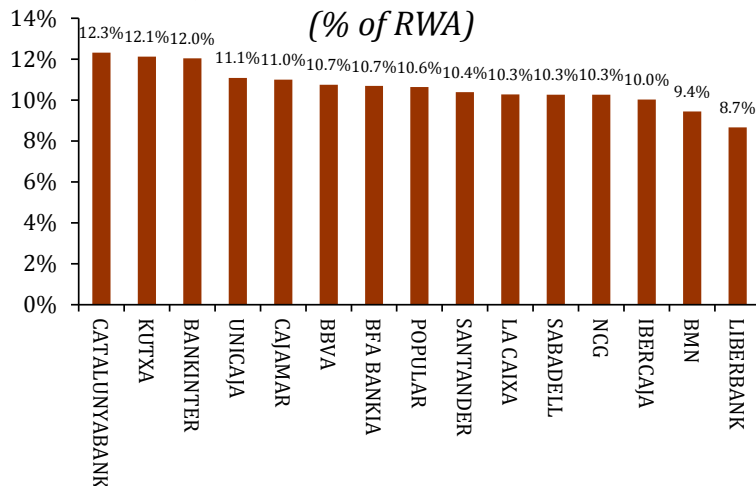
- ▶ The Comprehensive Assessment of the ECB has involved a full review of 130 banks from 18 euro area countries (plus Lithuania) → 81.6% of total risk-weighted assets.
- ▶ 15 Spanish banks have been scrutinised, accounting for 90% of the assets of total Spanish deposit-taking institutions

- ❑ Gross capital shortfall of €24.6 bn for 24 banks; €9.5 bn in net terms for 13 banks (after capital increases in 2014)
- ❑ Spanish banks have only one bank with a gross capital shortfall of €32mn under the stressed scenario

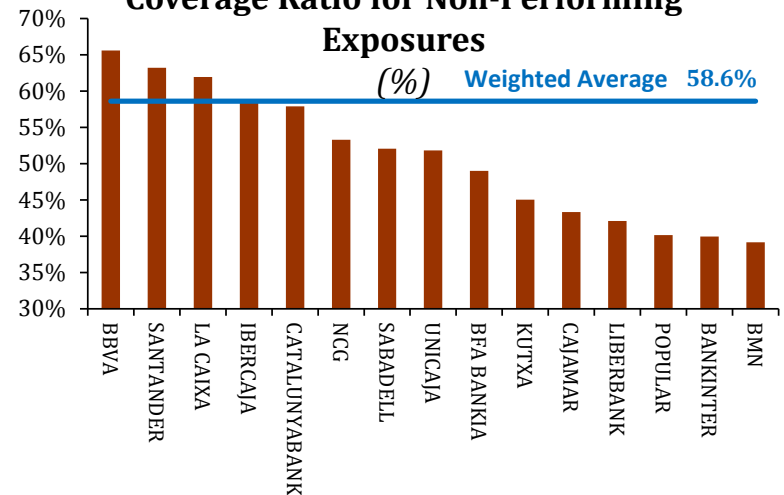
Spanish Banks: Size in €bn (LHS) and Cumulative Percentage of Analysed Assets (RHS)



Starting CET1 as of December 31st 2013 (% of RWA)



Coverage Ratio for Non-Performing Exposures (%)



Source: Bank of Spain.

Data

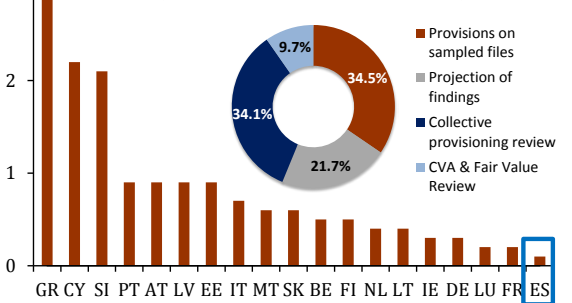
Results of the comprehensive assessment : AQR & stress tests

► The impact of the AQR on Spanish banks' RWA is 14bps, the lowest in the SSM, which reflects the appropriate classification, valuation and provisioning in the Spanish financial sector. Most of the gross adjustments due to the AQR (64%) were due to the collective provisioning review

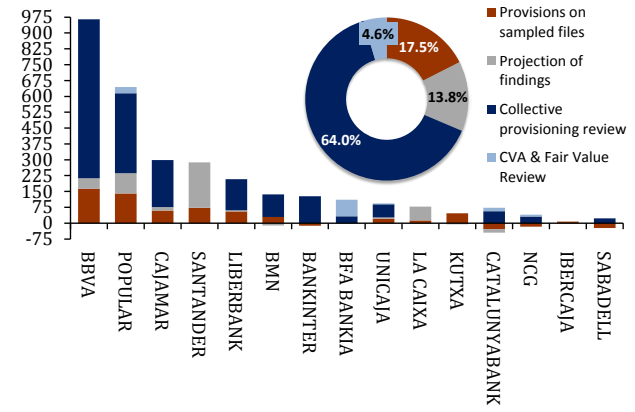
► The adverse scenario entails a substantial worsening of the Spanish economy, both in terms of growth and employment. The total net decline in capital arising from the stressed scenario amounts to 17.2 bn, i.e. 1.4pp of CET1 (vs. 3pp for the whole SSM)

► In Spain only one bank has evidenced an ex-ante capital shortfall (€32mn) which has been covered after corrective measures taken in 2014

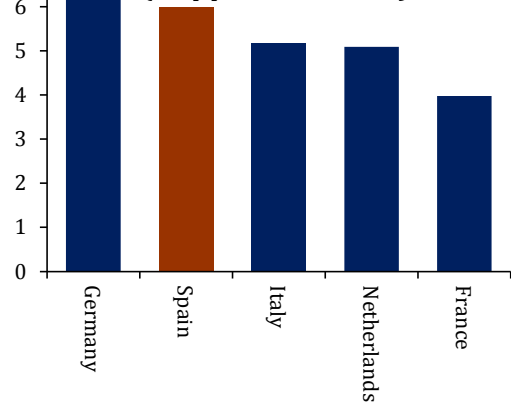
SSM: Gross Adjustments in the AQR
(% of RWA and % of total)



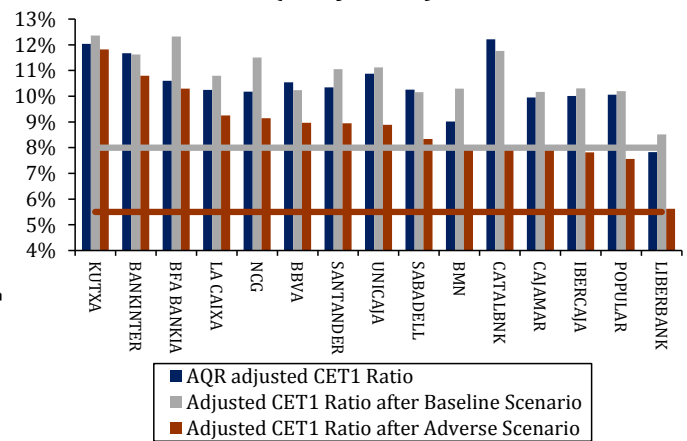
Spain: Breakdown of Gross Adjustments in the AQR
(€ mn and % of total)



GDP: Deviation Between IMF (Oct 2014) Forecasts vs. Stressed Scenario
(In pp. 2014-2016)



Evolution of CET1 in the Comprehensive Assessment
(% of RWA)



Source: Bank of Spain.

Data

1. Spanish Economic Policy

2. Transformation of Spain's Growth Model

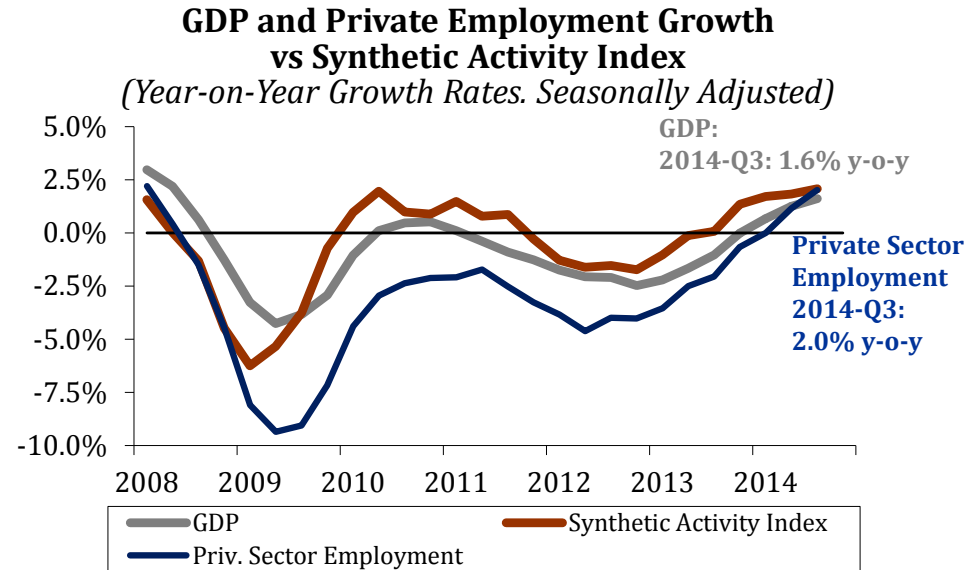
3. The Funding Programme of the Spanish Treasury

Transforming Spain's economic model

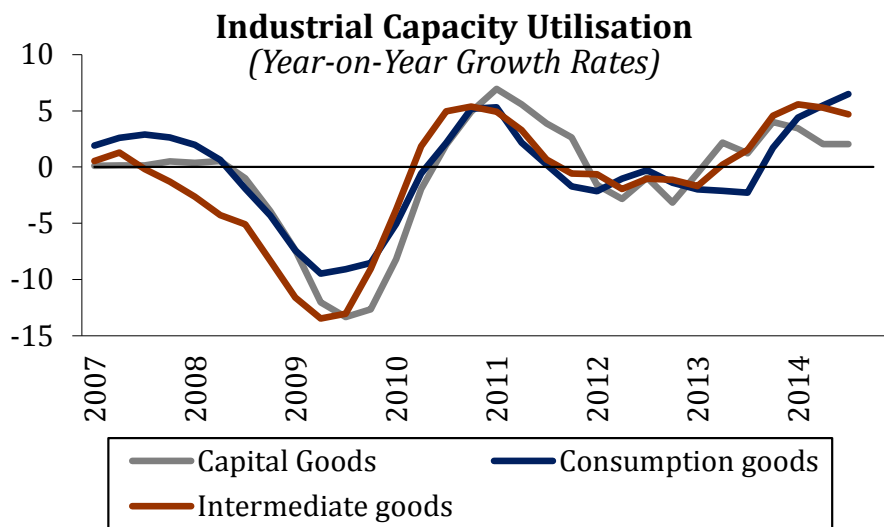
- ▶ The weight of exports in GDP has increased from 21.9% in 2009Q1 to 32.6% in 2014Q2
- ▶ The economy has evolved from being a net debtor one to a net lender to the rest of the world. The structural CA deficit has eroded notably; recent trends in merchandise exports support this process despite transitory 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; by 2014-Q2 adjustment in the private sector reached 34.9 pp of GDP since 2010
 - ❑ 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

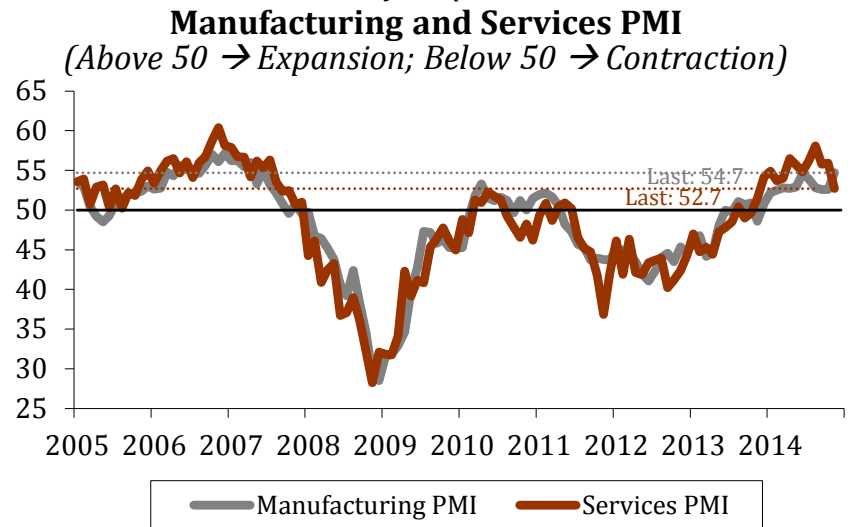
- ▶ Structural reforms implemented by the Spanish Government allow an increased effectiveness of demand-side economic policies, with positive impact on economic growth
- ▶ Recent coincident and leading indicators point towards an expansion, especially in the services sector



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



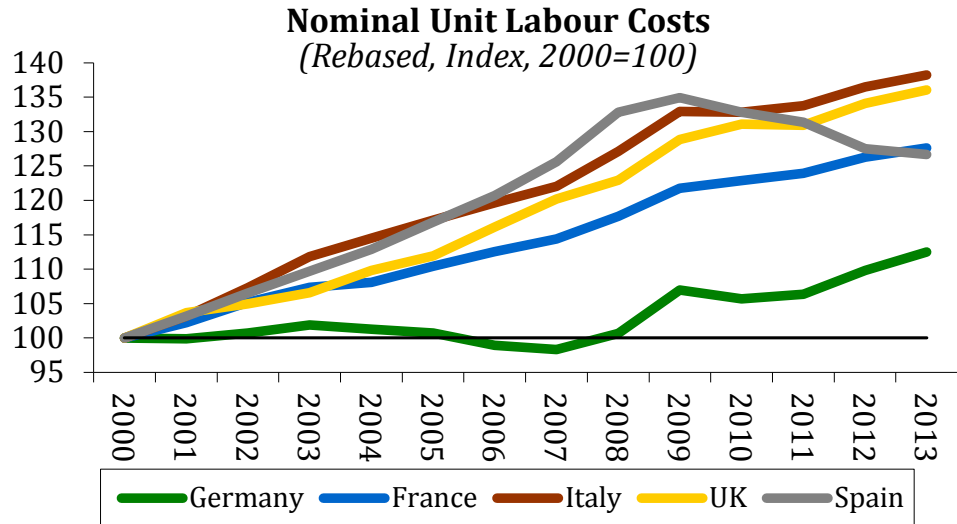
Source: Ministerio de Economía y Competitividad, [Data](#)



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

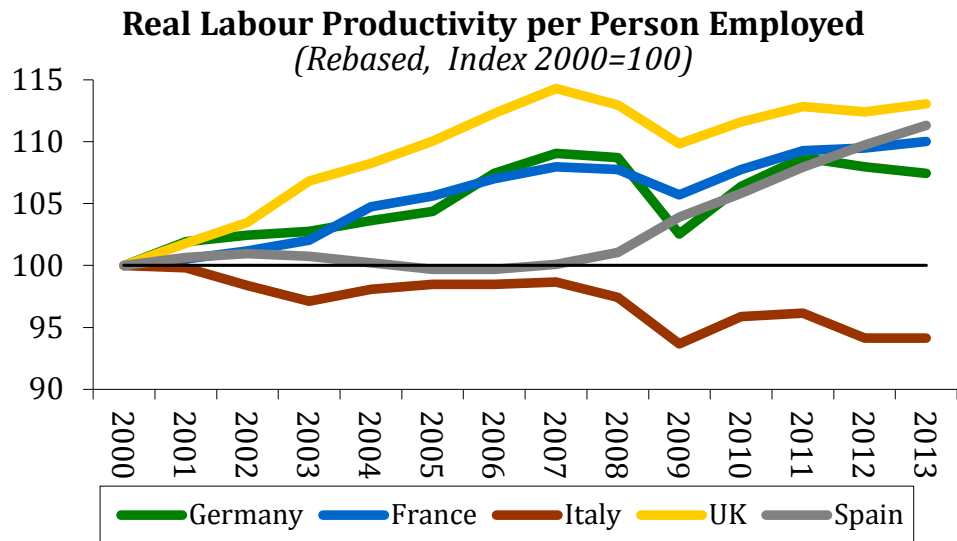
Wage moderation, rebalancing and competitiveness

- ▶ 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 6.9% since the peak in 2009 and are at similar levels than in 2007-Q2
 - ❑ 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](#)

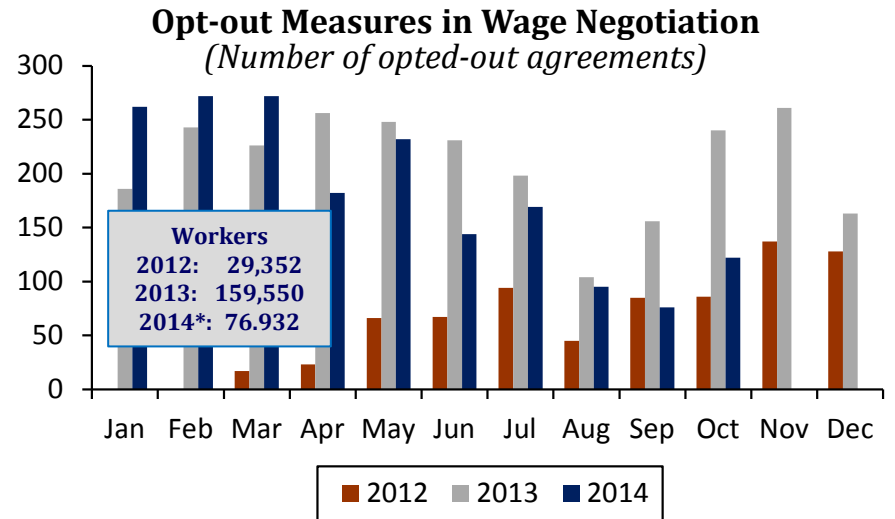


Source: Eurostat.

[Data](#)

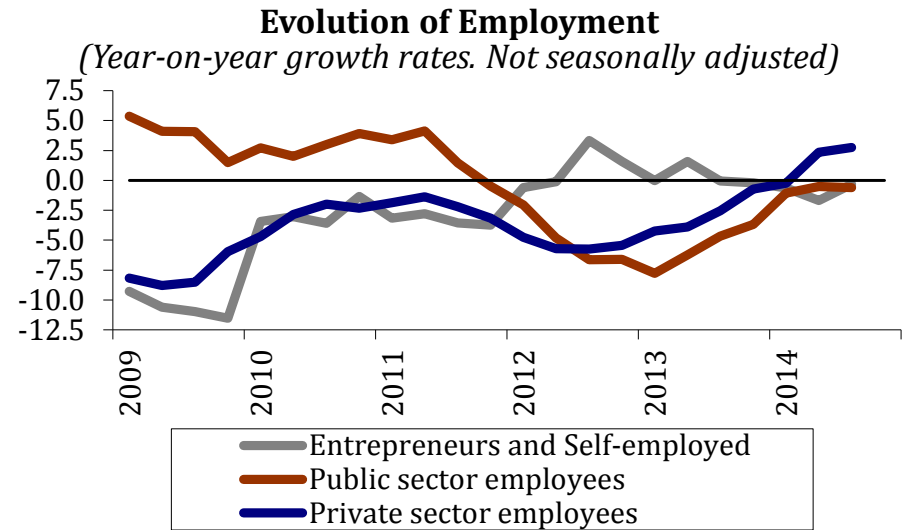
Labour market reform: wage moderation and enhanced flexibility mechanisms

- ▶ 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 employment, contraction of public sector
 - ❑ Since 2011 the number of employees in the public sector has diminished substantially, reaching 2007 levels: a reduction by 381,000 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 October 2013 to October 2014

[Data](#)



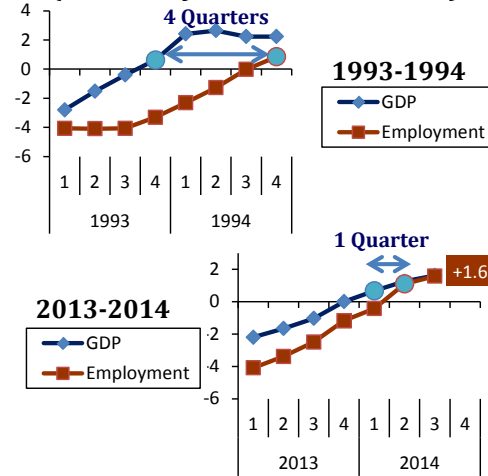
Source: National Statistics Institute.

[Data](#)

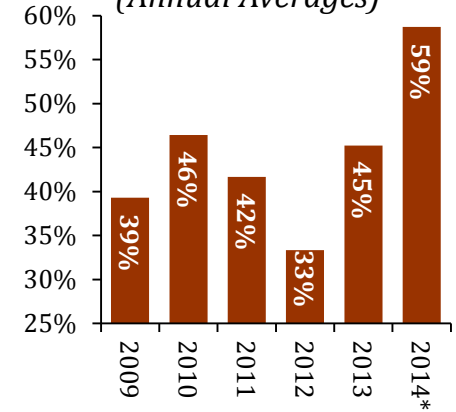
Lower growth needed for employment creation in the private sector

- ▶ New regulatory framework has affected the minimum GDP growth required for net job creation, while maintaining productivity growth → one quarter lag between GDP growth and employment creation
- ▶ Private sector employment has increased by 2% in the third quarter 0.4 pp above year-on-year GDP growth

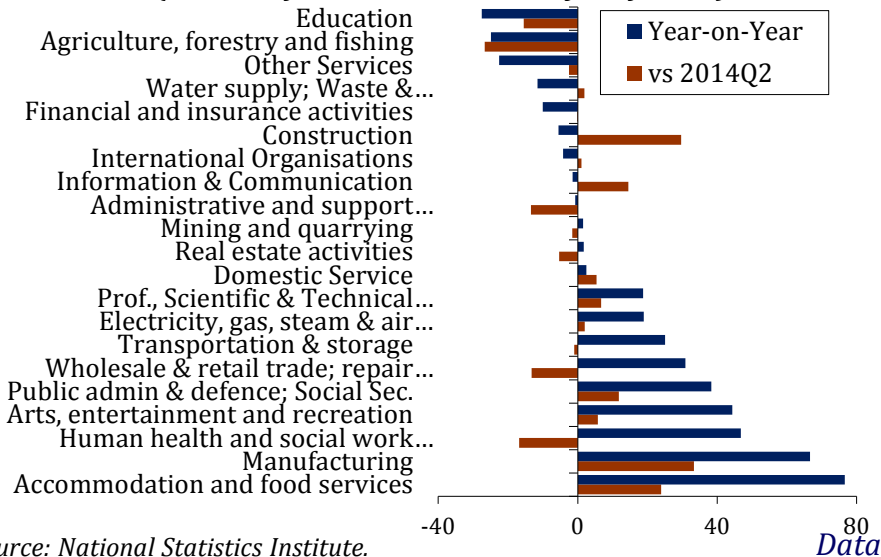
Employment vs. GDP Growth (Year-on-year Growth Rates)



% of Sectors with Quarterly Employment Growth (Annual Averages)



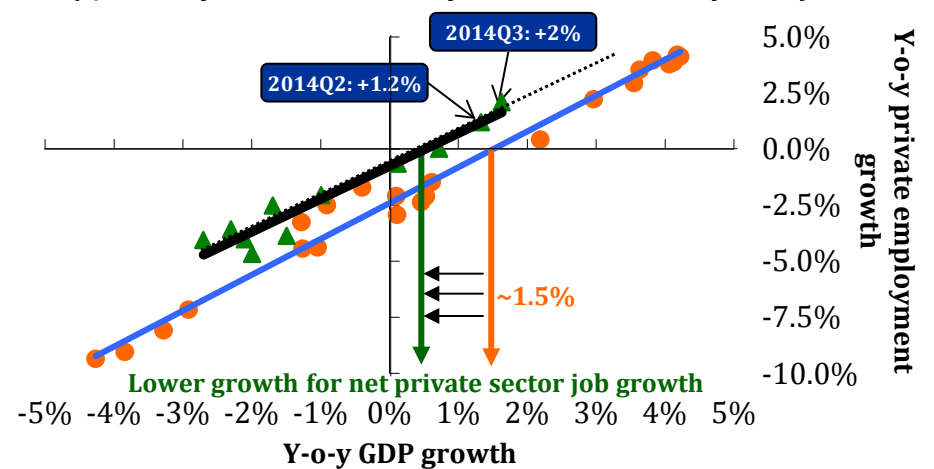
Employment by Branch (1,000s of Persons. Seasonally Adjusted)



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

[Data](#)

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



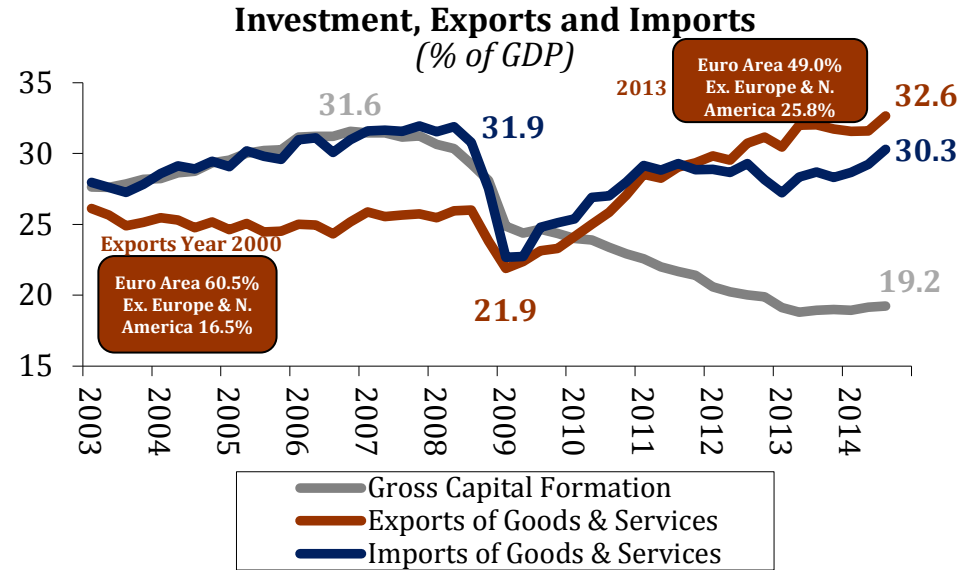
Source: National Statistics Institute.

Source: National Statistics Institute.

[Data](#)

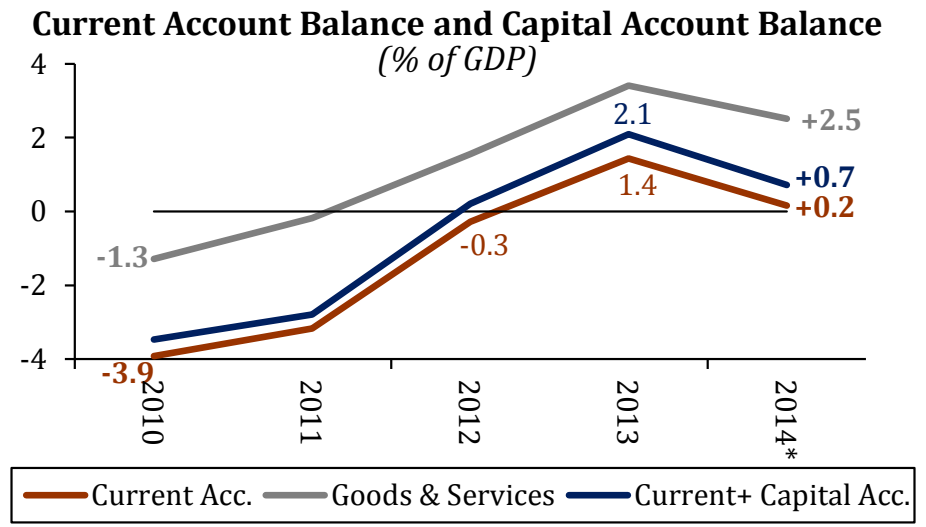
Rapid expansion of the external sector

- ▶ As a reflection of the structural change in the Spanish economy the weight of exports in GDP has increased from 21.9% in 2009Q1 to 32.6% by 2014Q3, while the weight of investment has declined substantially, from over 31.9% of GDP to 19.2% in 6 years
- ▶ In nominal terms imports of goods and services are close to 2008 levels → higher capital intensity and lower construction component
- ▶ Cumulative Current Account from September 2013 to September 2014: +0.2% of GDP, linked to higher imports of capital goods and income balance
- ▶ Current Account plus Capital Account (equivalent to net lending/borrowing capacity) stands at +0.7% of GDP



Source: National Statistics Institute.

Data



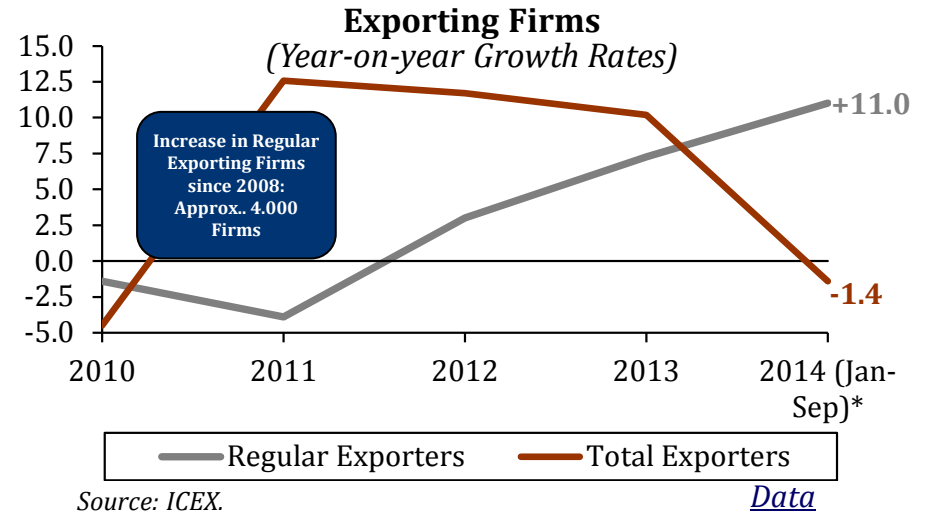
Source: Bank of Spain.

* Up to September 2014

Data

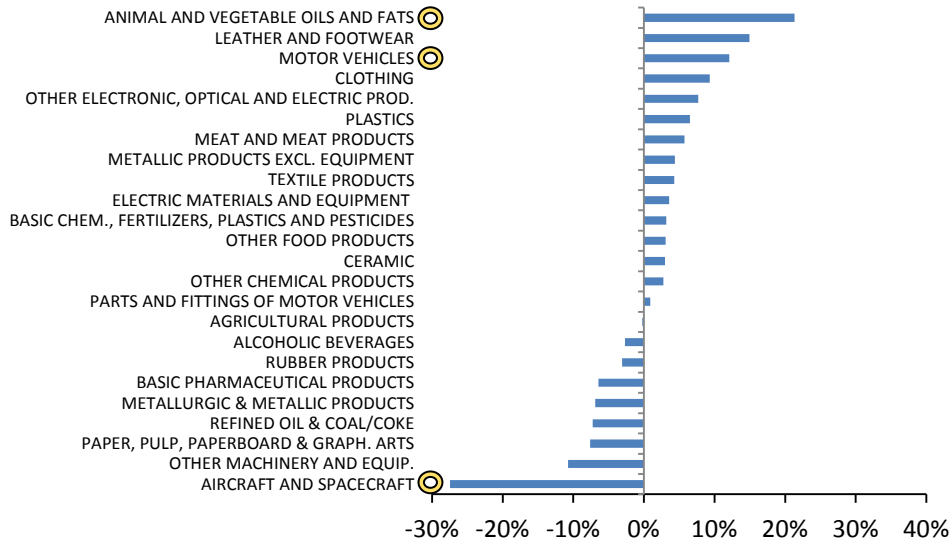
Recent evolution of the external sector

- ▶ Recent balance of payments statistics reflect a stabilising trend in exports; large ticket orders in 2013 in specific types of goods (Navantia, Mecca-Medina high speed rail project, etc.) impacted at the beginning of the year 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



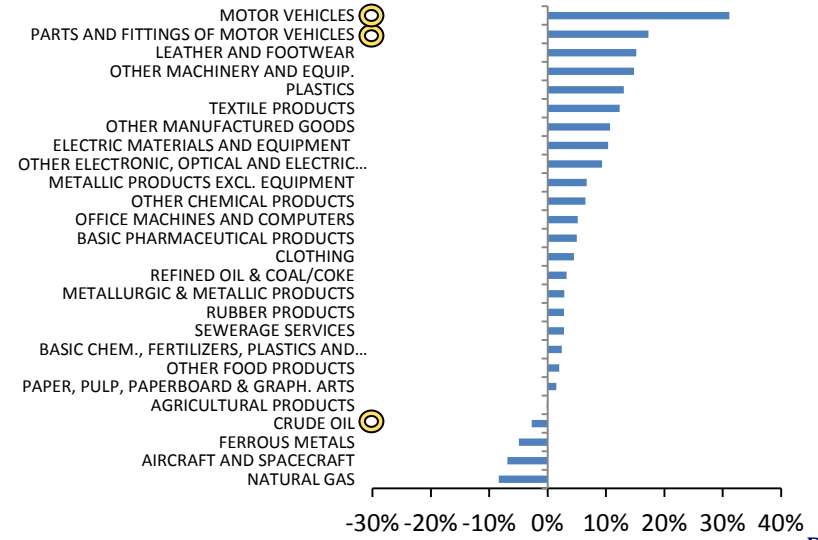
Main Export Products (yoy) ☉

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



Main Import Products (yoy) ☉

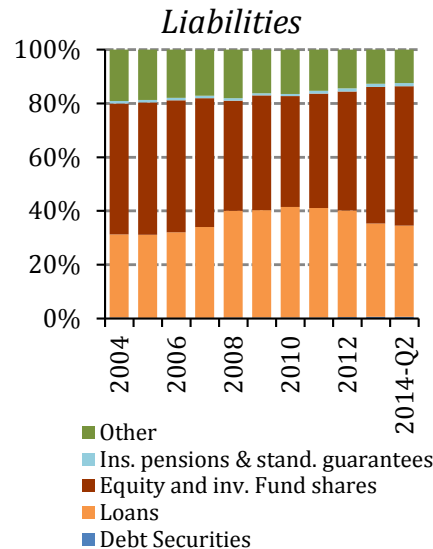
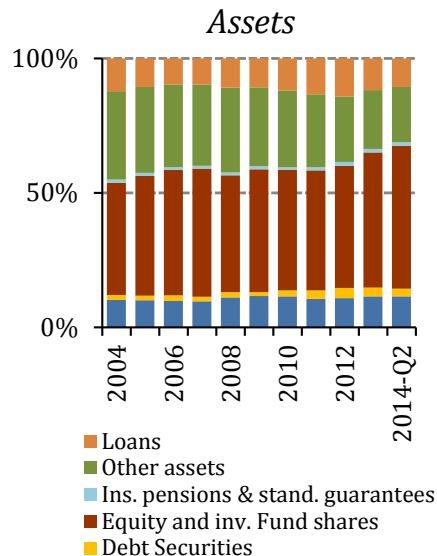
(With Weight in Total 2013 Merchandise Imports >1%. Smoothed data)



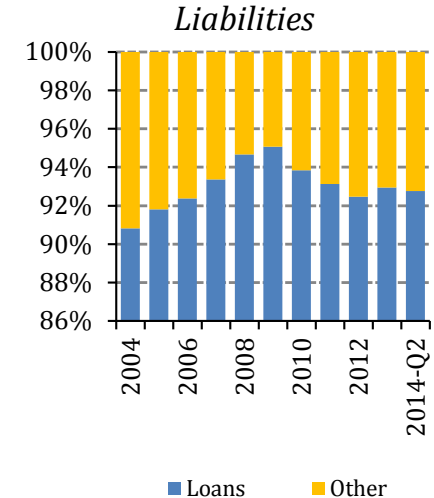
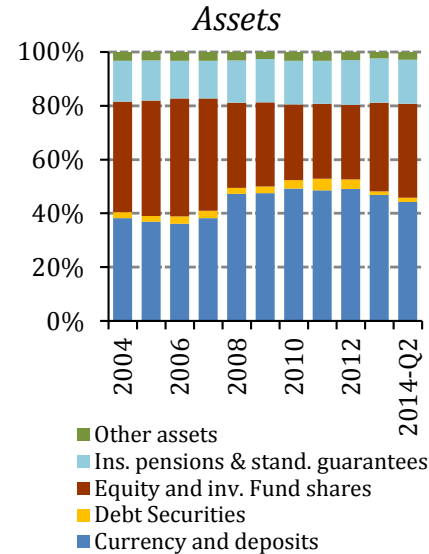
Deleveraging of the private sector: re-composition of assets and liabilities

- ▶ 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. 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)



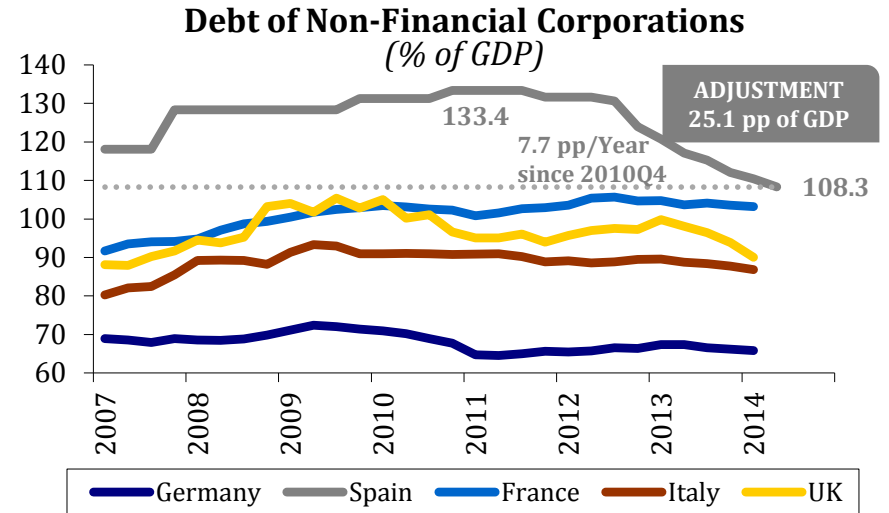
Source: Bank of Spain.

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

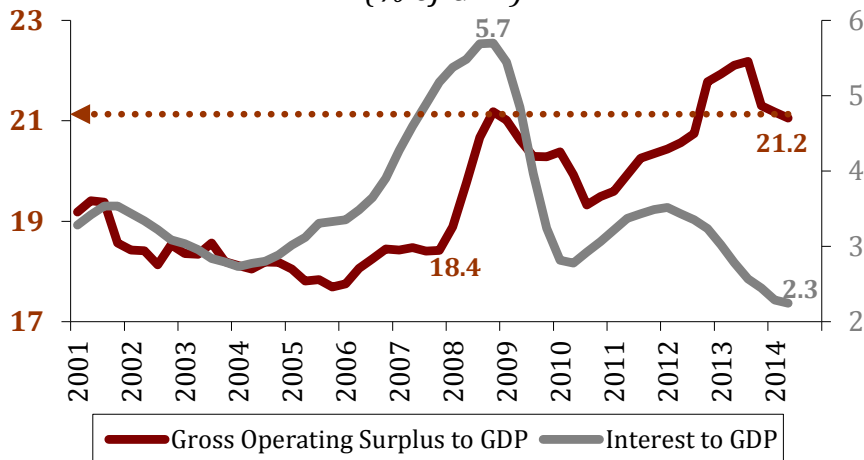
- ❑ Gross operating surplus of non-financial corporations has increased from below 18% of GDP to above 21% in 6 years
- ❑ Strong flow correction: indebtedness excl. equity to Gross Operating Surplus and to Gross Disposable income below 2002 levels



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

[Data](#)

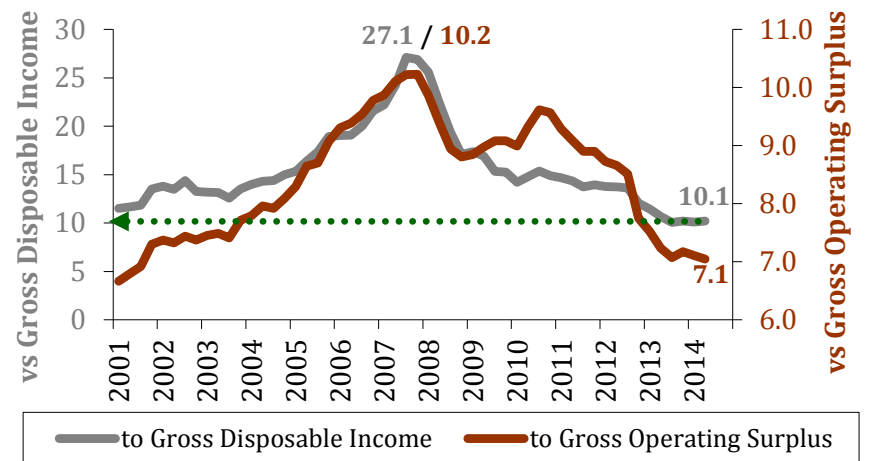
Gross Operating Surplus of Non-Financial Corporates and Interest Paid (% of GDP)



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

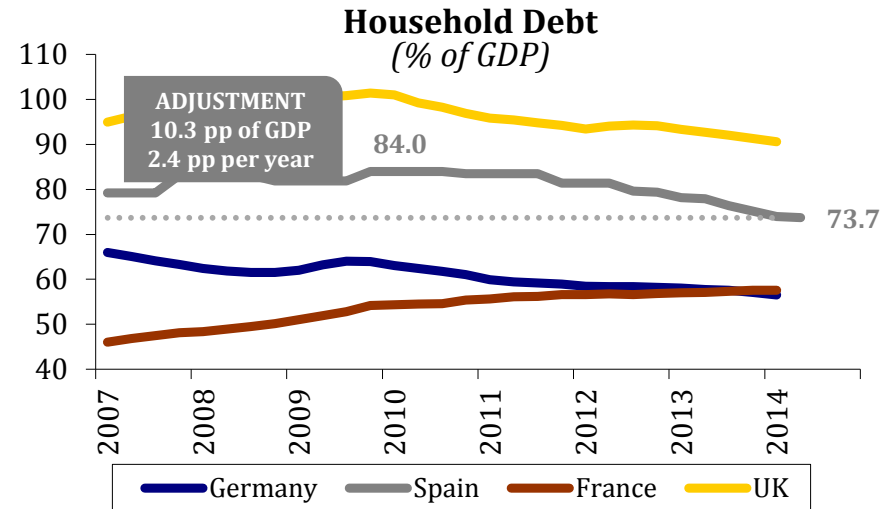
▶ Households have progressively reduced their leverage ratios and their debt is below 2007 levels

❑ 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

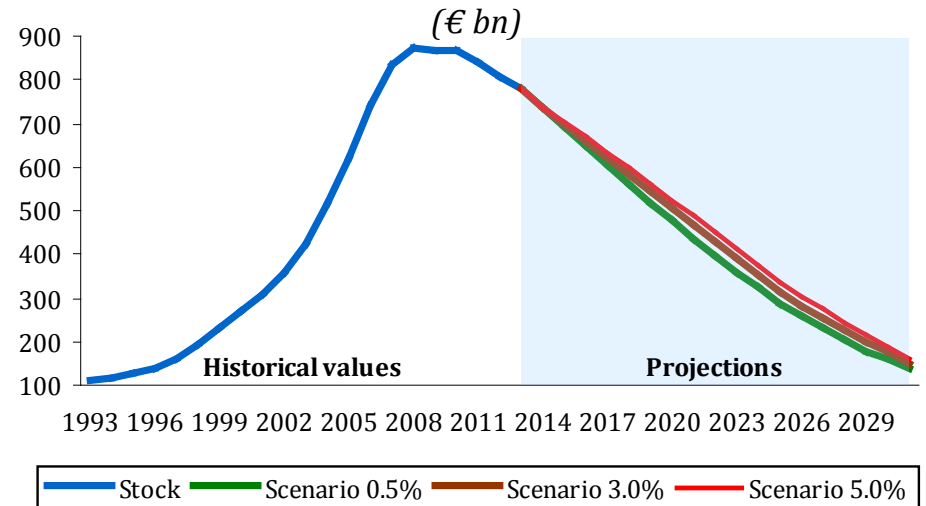
❑ By 2020-2023 the existing mortgage stock would be halved vs. today's levels



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

[Data](#)

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

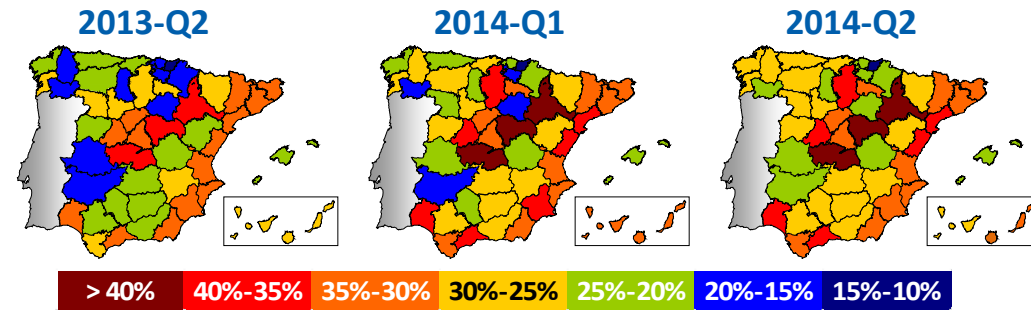


Source: Santander GBM Research.

The construction sector has accelerated its adjustment

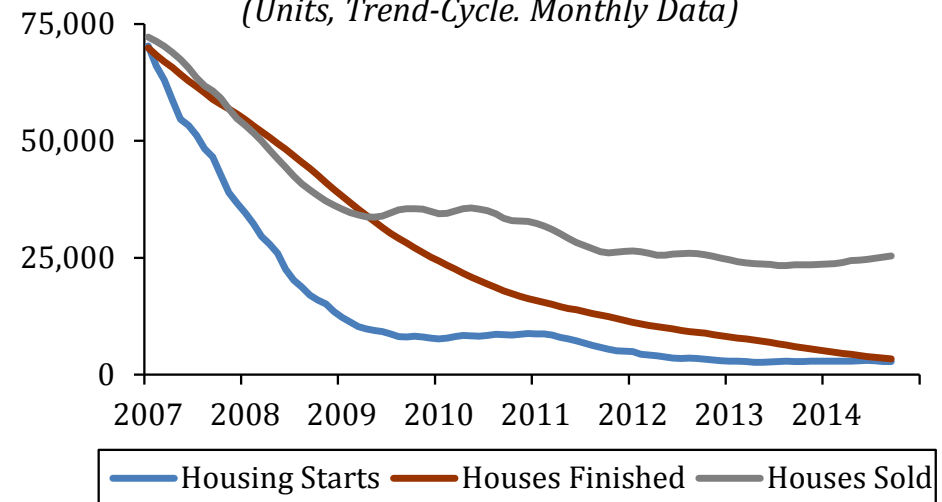
- ▶ Real estate prices have fallen on average by approx. 30% in nominal terms since the peak in 2008
- ▶ Recent data point towards milder declines around coastal areas and increased adjustment in the inner provinces
- ▶ The adjustment has been very heterogeneous and more intense around most populated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

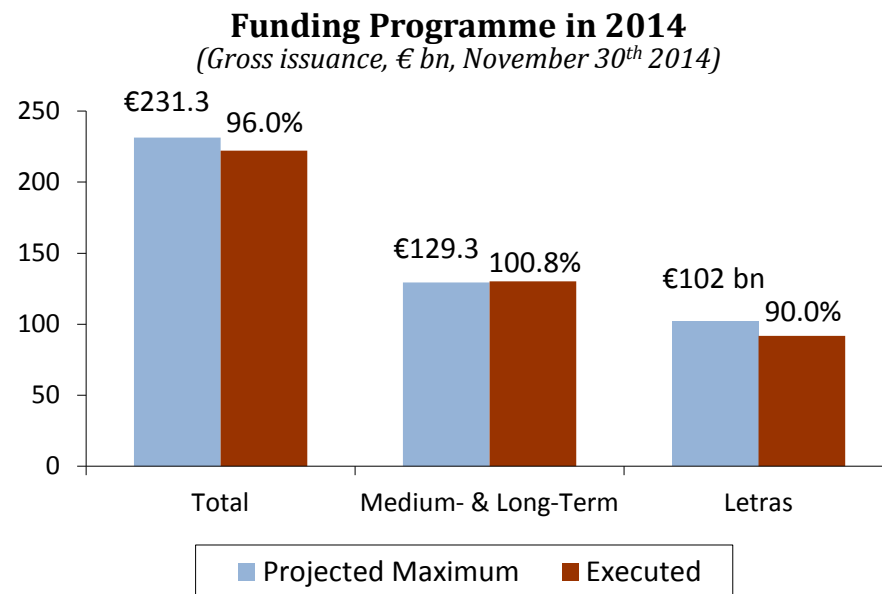
- ▶ In line with fiscal consolidation strategy for 2014, the net funding in the Treasury's Funding Programme for 2014 was revised downwards by €10 bn,
- ▶ Up to November 30th the Spanish Treasury has funded €130.3 bn, a 100.8% of the expected amount of the regular medium- and long-term gross issuance, and €91.8 bn, a 90% of its short-term programme
- ▶ Including Letras, the Spanish Treasury has issued €222.1 bn so far in 2014

<i>(billion euros, in effective terms)</i>	<i>January 2014</i>	<i>June 2014 Update</i>
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 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.

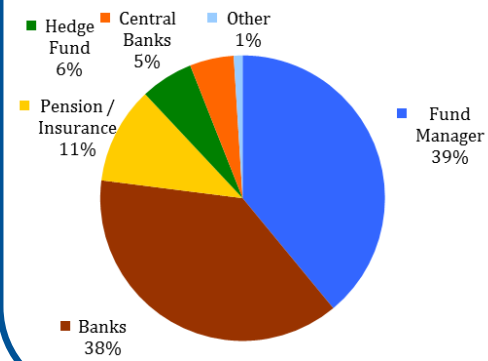
Data

Syndicated issuance in 2014

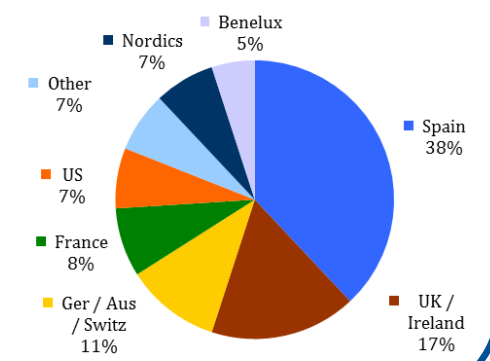
- ▶ In June 2014, the Spanish Treasury launched its third syndicated transaction of the year in concurrence with a switch offer (reducing the gross refinancing needs of the Kingdom of Spain in 2015)
- ▶ The new €9bn (€3.7bn switch / €5.3bn cash) 10 year benchmark issue (due 31 October 2024) has a 2.75% 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

by Type of Investor (%)

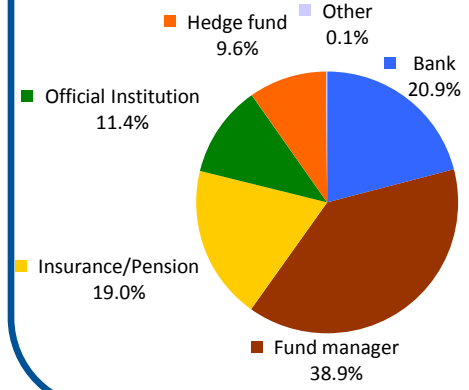


Geographic Distribution (%)

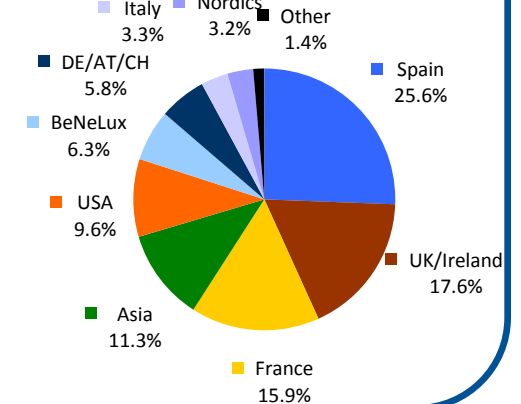


OCTOBER - NEW 5 YEAR BOND LINKED TO EA HICP EX. TOBACCO. NOVEMBER 2019

by Type of Investor (%)

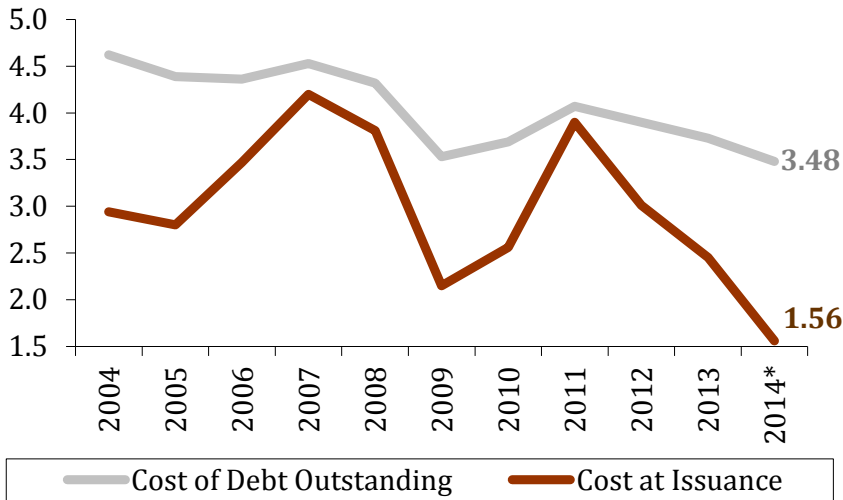


Geographic Distribution (%)

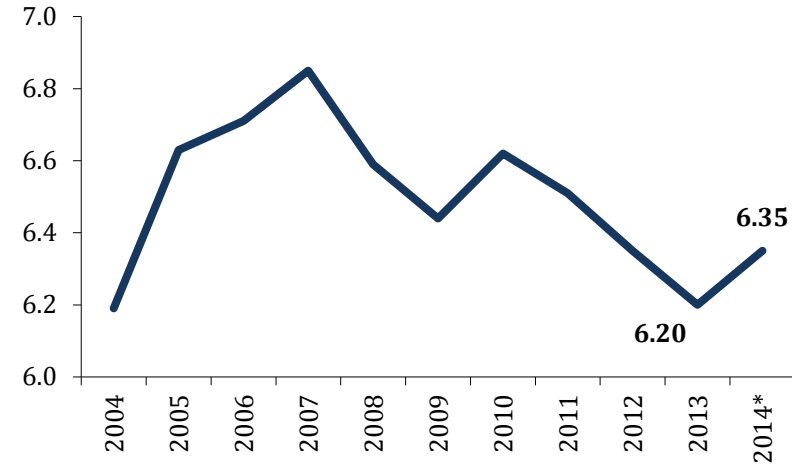


Cost and life of debt

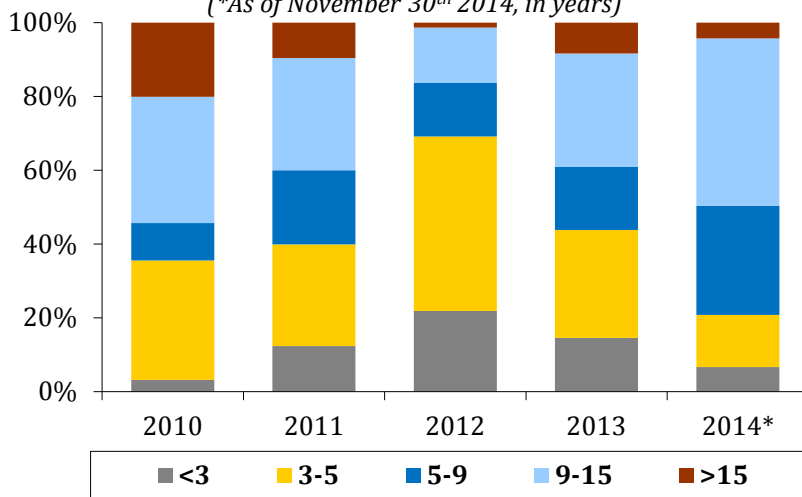
Cost of Debt Outstanding and Cost at Issuance
 (*As of November 30th 2014, in percent)



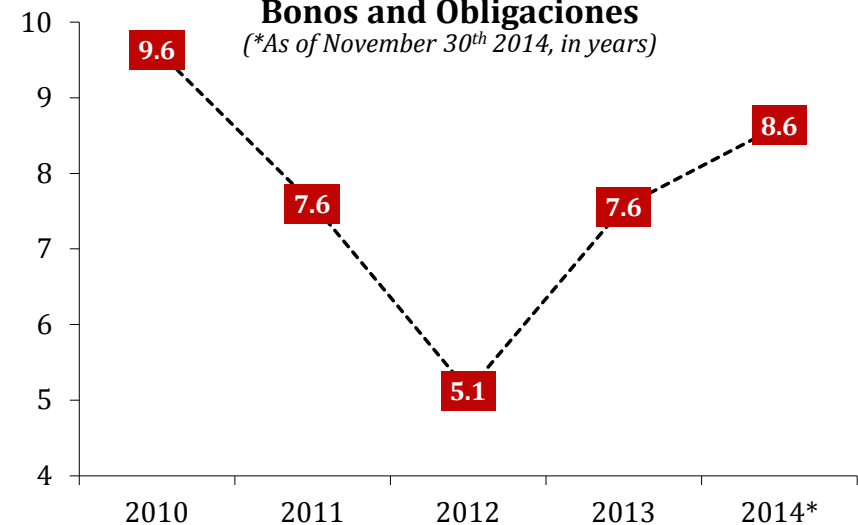
Average Life of Debt Outstanding
 (*As of November 30th 2014, in years)



Marginal Life at Issuance of Bonos and Obligaciones
 (*As of November 30th 2014, in years)



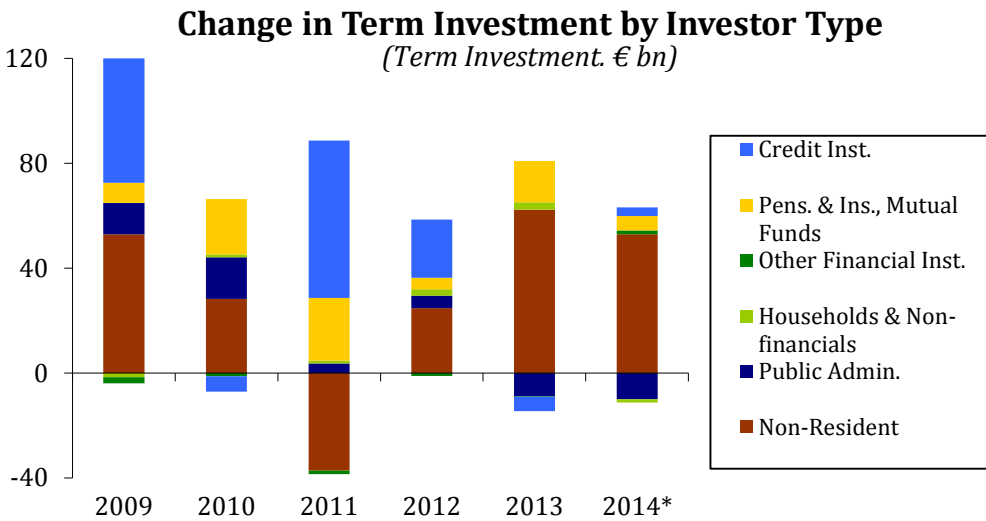
Average Life at Issuance of Bonos and Obligaciones
 (*As of November 30th 2014, in years)



Source: Secretaría General del Tesoro y Política Financiera.

[Data](#)

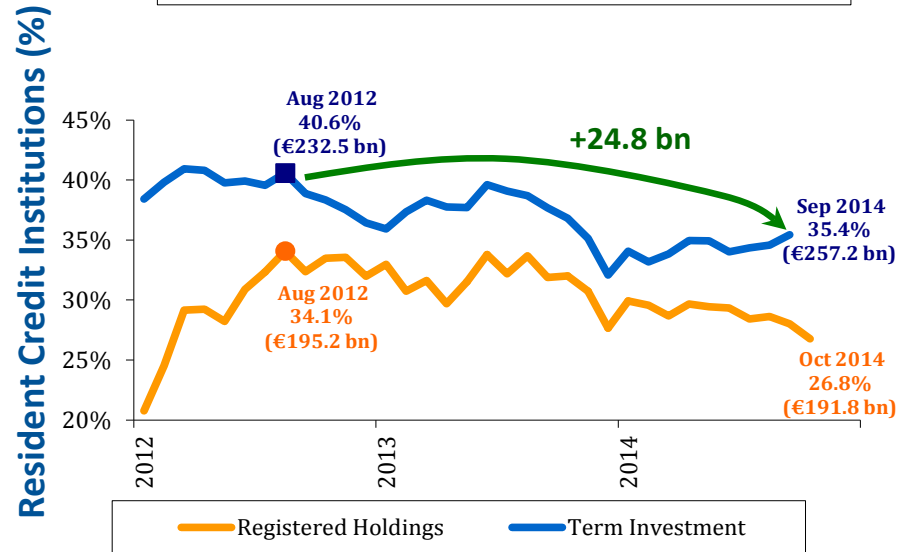
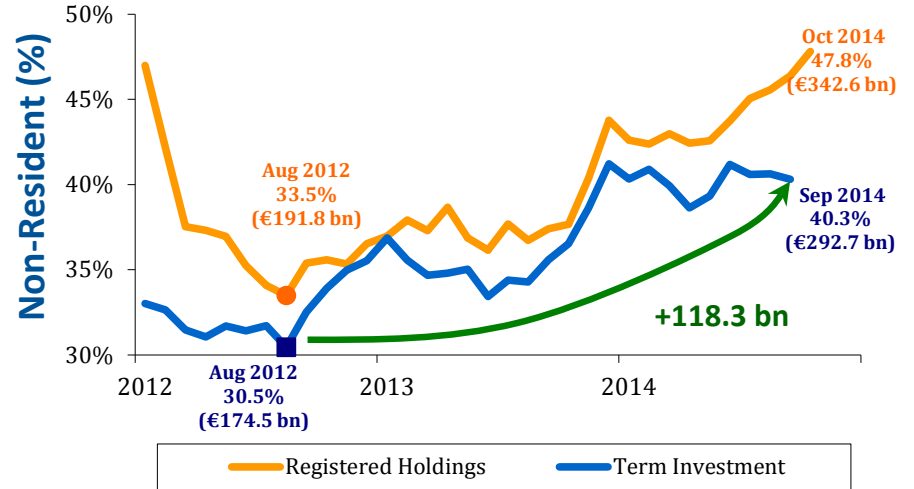
Recent trends in investor base



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

Data

Holdings of Unstripped Government Debt

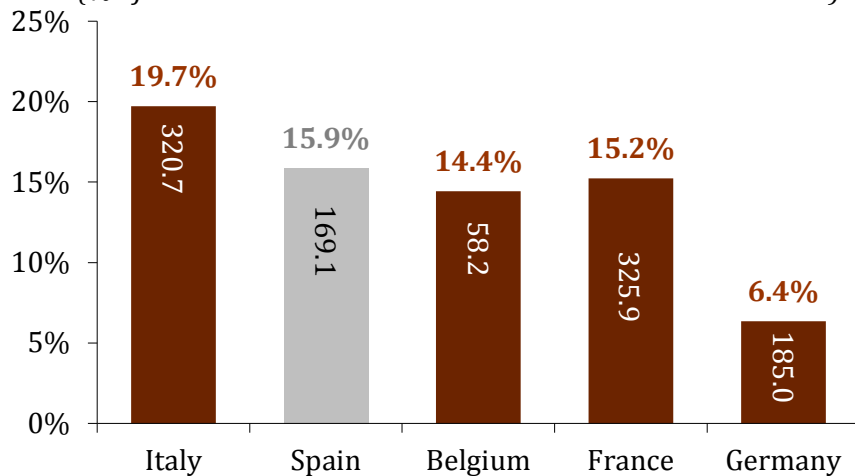


Prudent debt management

- ▶ 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

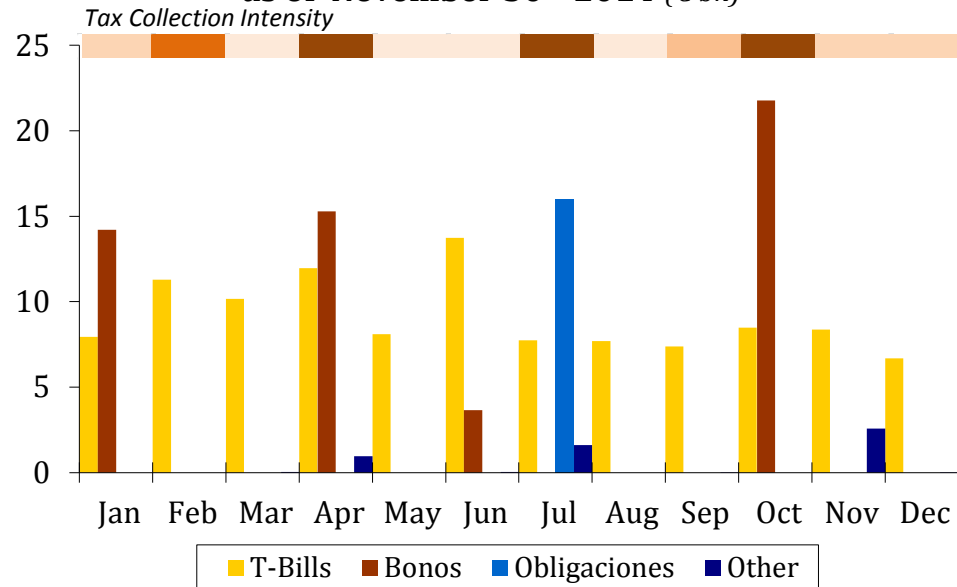
Relative Redemptions, including T-Bills

(% of estimated 2014 GDP. December 2014 to November 2015)



Sources: Secretaría General del Tesoro y Política Financiera for Spain, October 31st data for Italy, and Bloomberg for other countries. [Data](#)

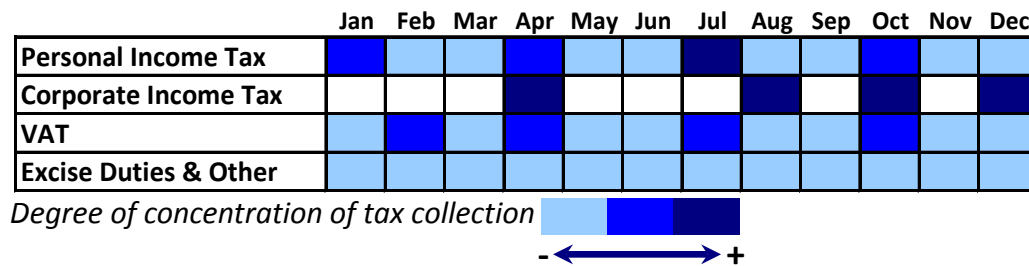
Monthly Maturity Structure in 2014 as of November 30th 2014 (€ bn)



Source: Secretaría General del Tesoro y Política Financiera.

[Data](#)

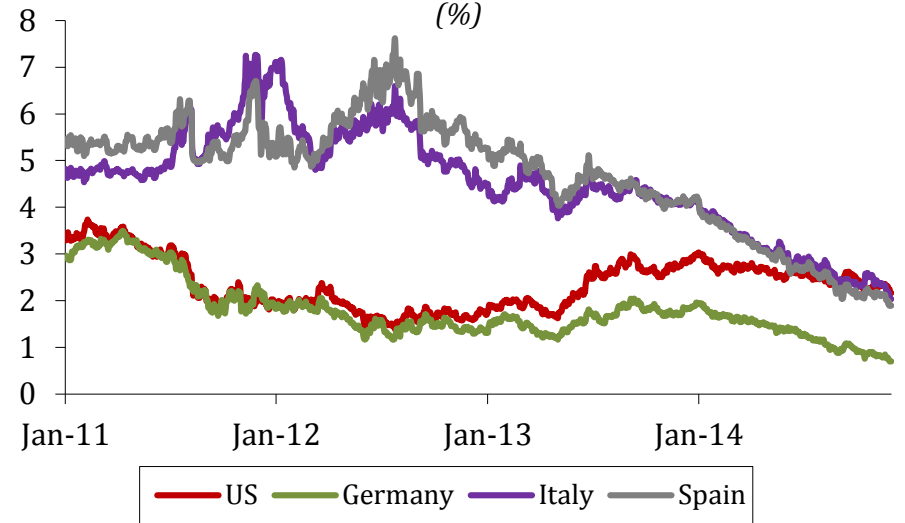
Administrative Distribution of Tax Collection



Interest rate volatility has diminished

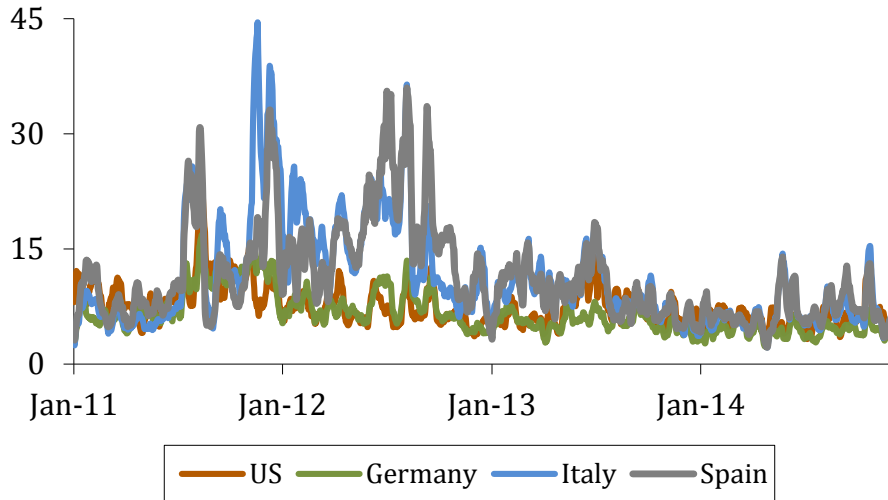
- ▶ Significant tightening in sovereign spreads
- ▶ Rates have stabilised for longer periods, enabling more efficient investment decisions by market agents

Generic 10-year Government Bond Average Yield Levels



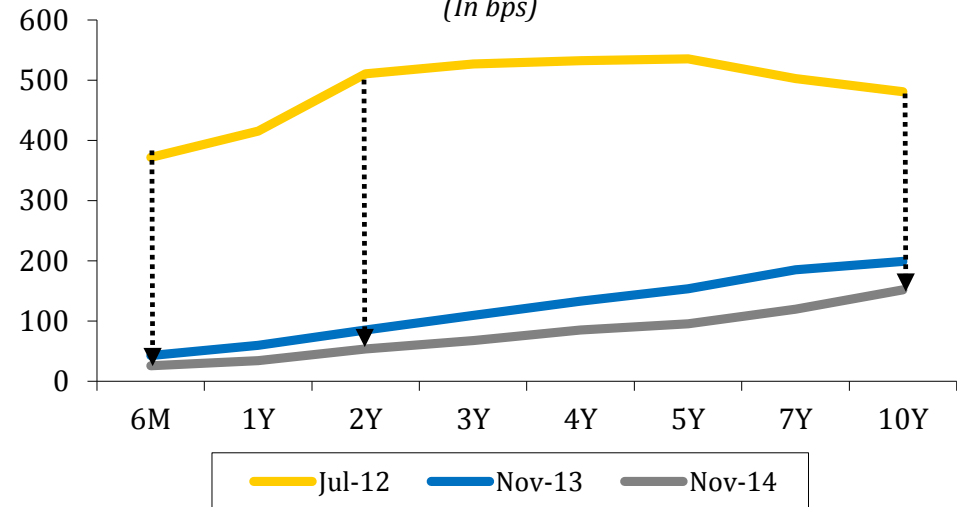
Intraday Yield Range, 10-Day Rolling Average

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



Spain CDS Curves

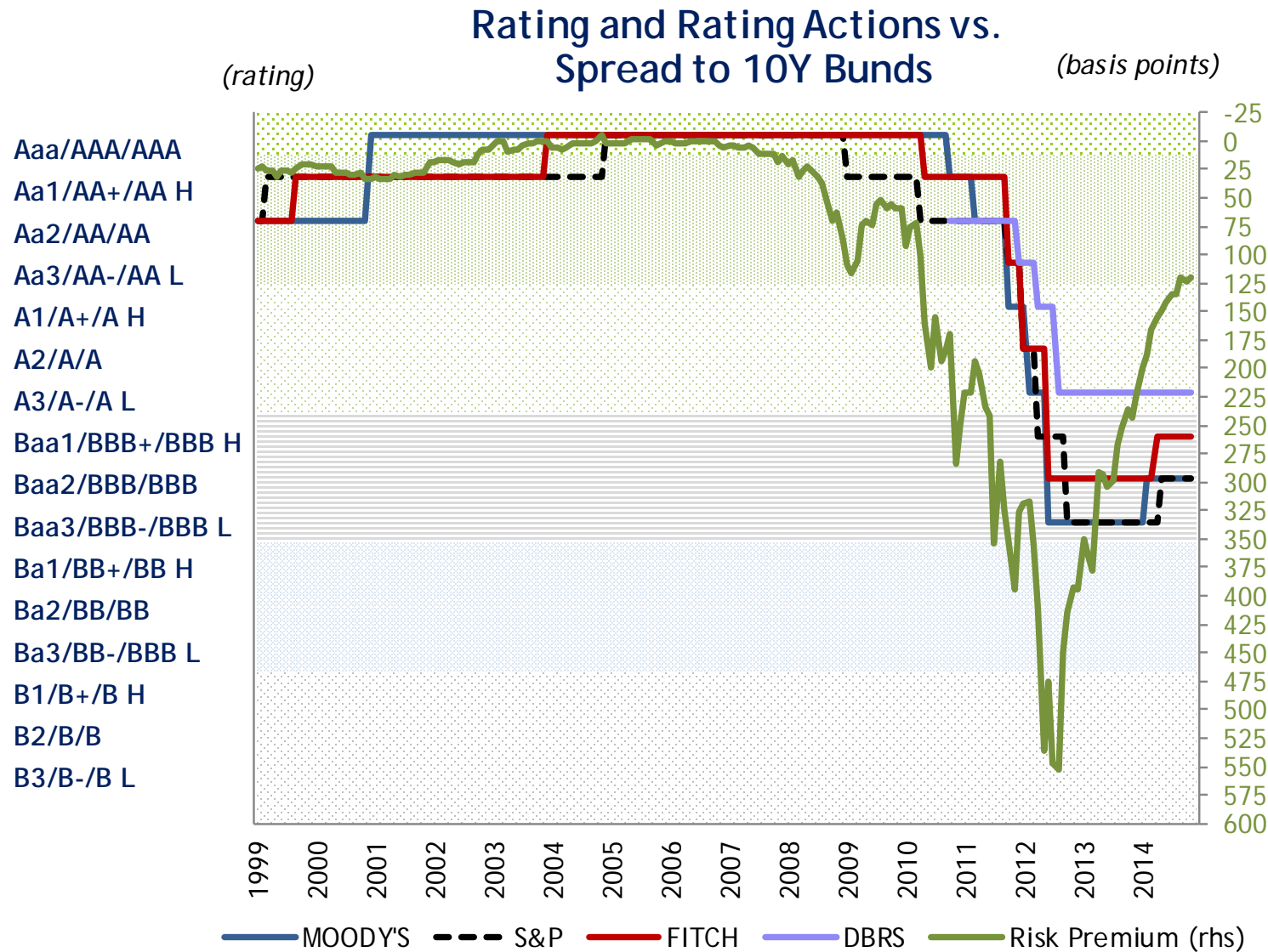
(In bps)



Source: Bloomberg.

Data

Evolution of Ratings



[Data](#)

More and updated information on the Spanish economy



For spreadsheets click on 'Data'

[Click here to download all spreadsheets](#)

Thank you for your attention

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