



The Kingdom of Spain: Economic Policy & Funding

June 2015

1. Macroeconomic Outlook

2. Spanish Economic Policy & Reforms

3. The Funding Programme of the Spanish Treasury

Macroeconomic scenario 2015-2018

- ▶ Acceleration of GDP towards 2.9% YoY in 2015 & 2016 and 3.0% in 2017 & 2018
- ▶ Private consumption and investment to exert the initial push on economic activity
- ▶ Sustained net lending capacity vis-à-vis the rest of the world
- ▶ Unemployment rate forecast to break below the 20% barrier by 2016 and reach an average of 15.6% by 2018 with 2.100.000 net jobs to be created in the forecast horizon

Macroeconomic scenario (YoY growth rates in percent)					
	2014	2015	2016	2017	2018
Private consumption expenditure	2.4	3.3	2.9	2.7	2.5
General Government consumption expenditure	0.1	0.1	0.1	1.0	1.5
Gross Fixed Capital Formation	3.4	6.3	5.8	5.9	5.9
National Demand*	2.2	3.2	2.9	3.0	2.9
Exports of goods and services	4.2	5.4	6.0	5.8	5.7
Imports of goods and services	7.6	6.7	6.4	6.3	6.2
External demand*	-0.8	-0.2	0.1	0.0	0.1
Gross Domestic Product	1.4	2.9	2.9	3.0	3.0

Other macroeconomic variables					
	2014	2015	2016	2017	2018
Unemployment rate (in %)	24.4	22.1	19.8	17.7	15.6
Full-time Equiv. Employment (YoY Growth)	1.2	3.0	3.0	2.9	2.9
Unit Labour costs (YoY Growth)	-0.4	0.3	1.1	1.3	1.4
Net lending(+)/borrowing(-) with RoW (% of GDP)	1.0	1.7	1.8	1.6	1.4
GDP deflator (YoY Growth)	-0.5	0.6	0.9	1.2	1.6
Deficit Excl. Financial Sector One-Offs (in % of GDP)	-5.7	-4.2	-2.8	-1.4	-0.3
Primary Deficit(-)/Surplus(+) Excl. Financial Sector	-2.4	-1.1	0.1	1.2	2.2
Debt/GDP ratio (in % of GDP)	97.7	98.9	98.5	96.5	93.2

Underlying assumptions					
	2014	2015	2016	2017	2018
USD/€ exchange rate	1.3	1.1	1.1	1.1	1.1
World GDP growth, excl. EU (YoY Growth)	3.7	4.0	4.4	4.5	4.6
World Import Volume, excl. EU (YoY Growth)	2.1	3.9	5.2	5.5	6.0
Spanish Export Market Growth (YoY Growth)	2.4	3.8	4.9	5.2	5.4
Euro Area GDP growth (YoY growth)	0.9	1.5	1.9	2.1	2.2
Oil prices (Brent, USD/barrel)	99.4	61.5	68.8	68.8	68.8

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

* Contributions to GDP in p.p.

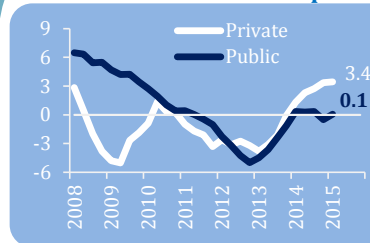
[Link to Data](#)

Recent macroeconomic indicators

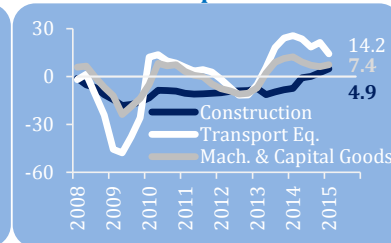
		2011	2012	2013	2014	Last	Date
PUBLIC SECTOR	Deficit, excl. financial sector one-offs (% GDP)	-8.9	-6.6	-6.3	-5.7	-5.7	2014Q4
	Debt to Gross Domestic Product (% GDP)	69.2	84.4	92.1	97.7	97.7	2014Q4
LABOUR MARKET	Wage increase agreed (y-o-y growth)	2.7%	1.7%	0.6%	0.6%	0.2%	Apr 2015
	Unit labour costs. Total economy (y-o-y growth)	-1.1%	-3.0%	-0.4%	-0.4%	1.0%	2015Q1
	Productivity per employee (y-o-y growth)	2.0%	2.5%	2.1%	0.2%	-0.1%	2015Q1
	Private Sector Employment (y-o-y growth)	-2.4%	-4.1%	-2.2%	1.5%	3.3%	2015Q1
	Unemployment rate (in % of Active Population)	21.4%	24.8%	26.1%	24.4%	23.8%	2015Q1
SUPPLY SIDE	Manufacturing PMI (Index >50 --> expansion)	47.3	43.8	48.5	53.2	55.8	May 2015
	Services PMI (Index >50 --> expansion)	46.5	43.1	48.3	55.2	58.4	May 2015
	Industrial Production Index (y-o-y growth)	-1.5%	-6.6%	-1.6%	1.2%	2.9%	Mar 2015
DEMAND SIDE	Sales in Large Companies (y-o-y growth)	-3.4%	-6.0%	-2.9%	2.4%	8.2%	Mar 2015
	Retail sales index deflated (y-o-y growth)	-5.6%	-7.4%	-3.9%	1.1%	4.3%	Apr 2015
	Passenger car registrations (y-o-y growth)	-19.2%	-12.1%	4.1%	18.8%	15.2%	May 2015
	Composite Consumption Indicator (y-o-y growth)	-1.8%	-2.8%	1.0%	3.9%	5.5%	Mar 2015
EXTERNAL SECTOR	Current account balance (% GDP)	-3.2%	-0.3%	1.4%	0.8%	1.0%	Mar 2015
	Current & Capital Account (% GDP)	-2.8%	0.2%	2.1%	1.2%	1.3%	Mar 2015
	Net International Investment Position (% GDP)	88.9%	-90.0%	-93.8%	-93.5%	-93.5%	2014Q4
	Exports of goods (y-o-y growth)	15.2%	5.1%	4.3%	1.8%	12.5%	Mar 2015
	Goods & Services Balance (€ mn)	-1,888	16,451	35,731	27,239	28,800	Mar 2015
FINANCIAL SECTOR	Equity to Assets Ratio (in %)	6.4	6.4	6.8	7.9	7.9	2015Q1
	Loan to Deposits Ratio (in %)	151.1	151.0	130.2	122.8	120.2	2015Q1
PRIVATE DEBT	Gross debt. Non financial corporates (% GDP)	131.9	124.5	117.5	111.1	111.1	2014Q4
	Gross debt. Households. (% GDP)	81.4	79.4	75.2	71.3	71.3	2014Q4

QUARTERLY NATIONAL ACCOUNTS (Year-on-Year Growth Rates)

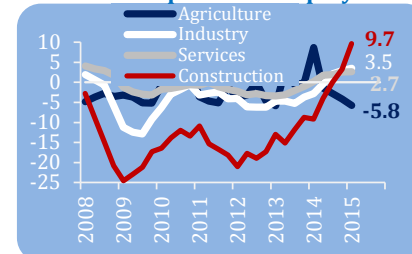
Private & Public Consumption



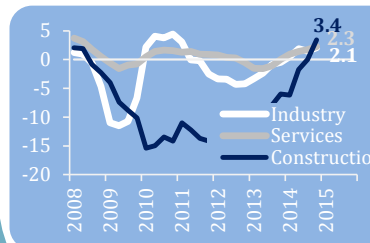
Gross Fixed Capital Formation



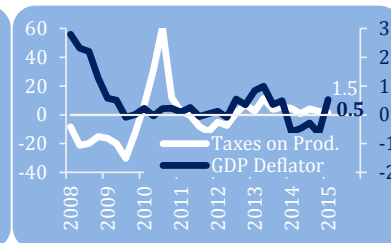
Full-Time Equivalent Employment



Gross Value Added

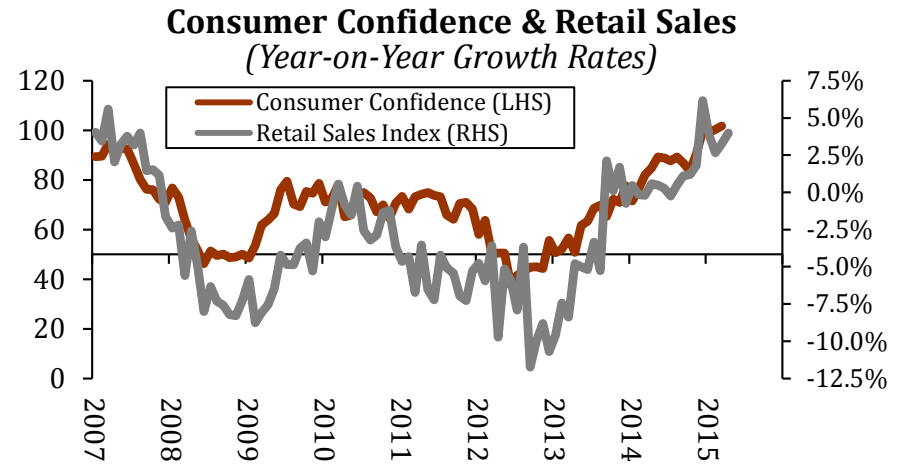


Net Taxes on Products vs. Deflator

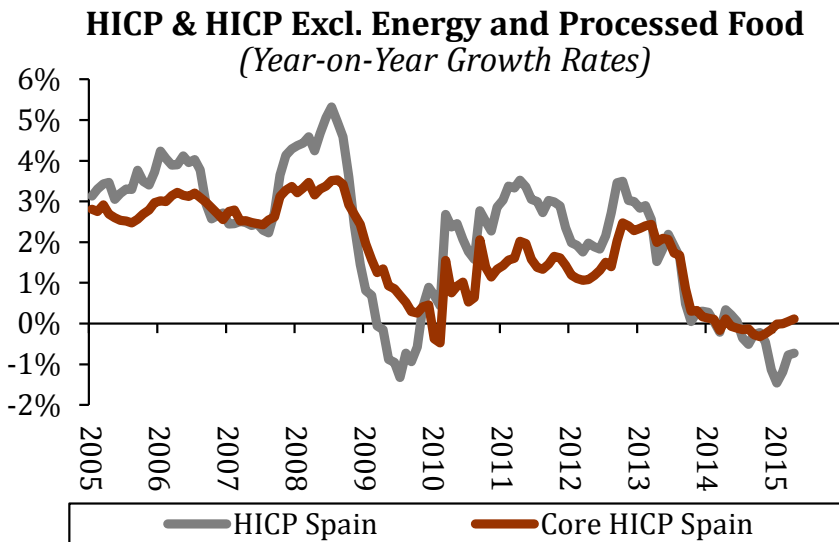


Consumer confidence at early 2007 levels

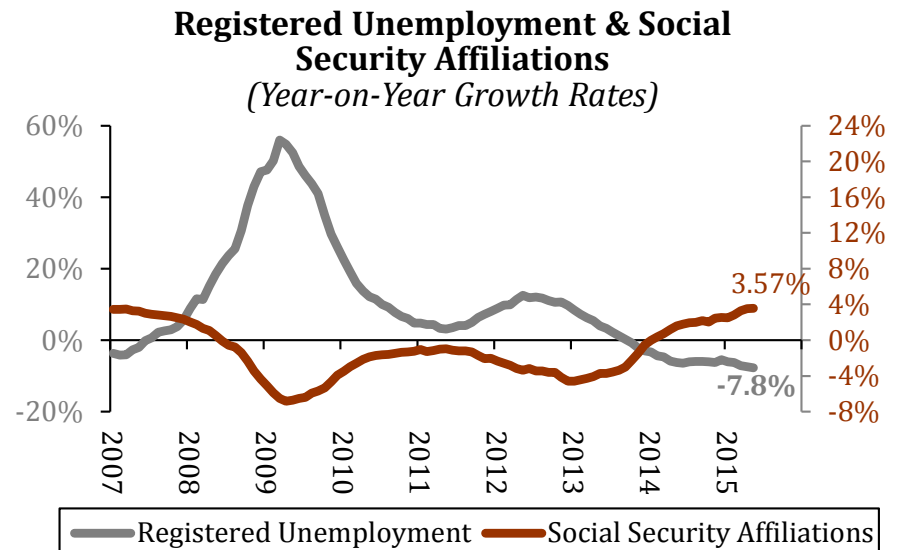
- ▶ Consumer confidence is picking up and already at early 2007 levels
- ▶ In line with recent developments in the labour market and retail sales, amongst other indicators
- ▶ Core inflation is starting to recover after a protracted period low inflation but despite these developments the favourable inflation differential vs. the European Union remains



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



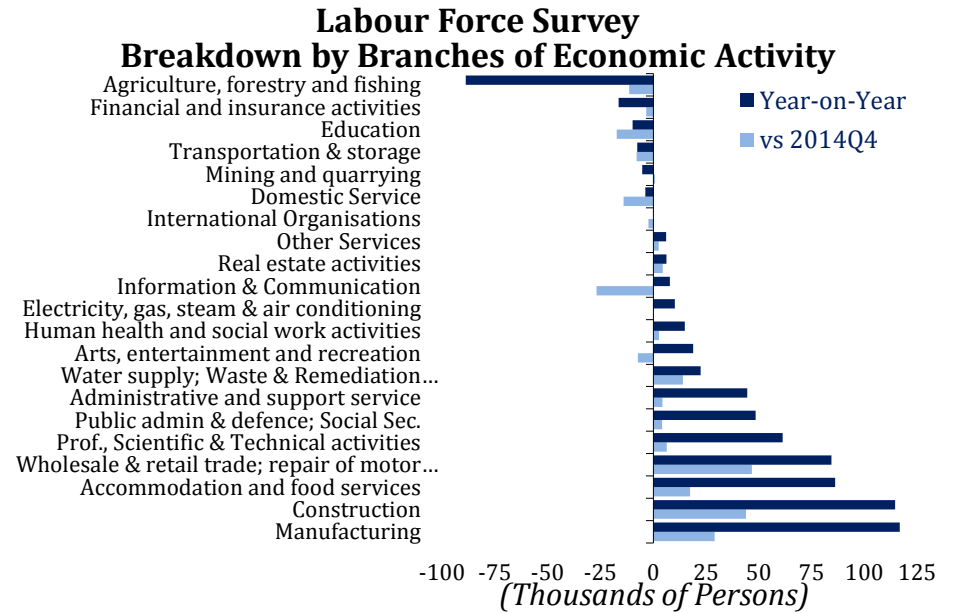
Source: Ministerio de Economía y Competitividad. [Link to Data](#)



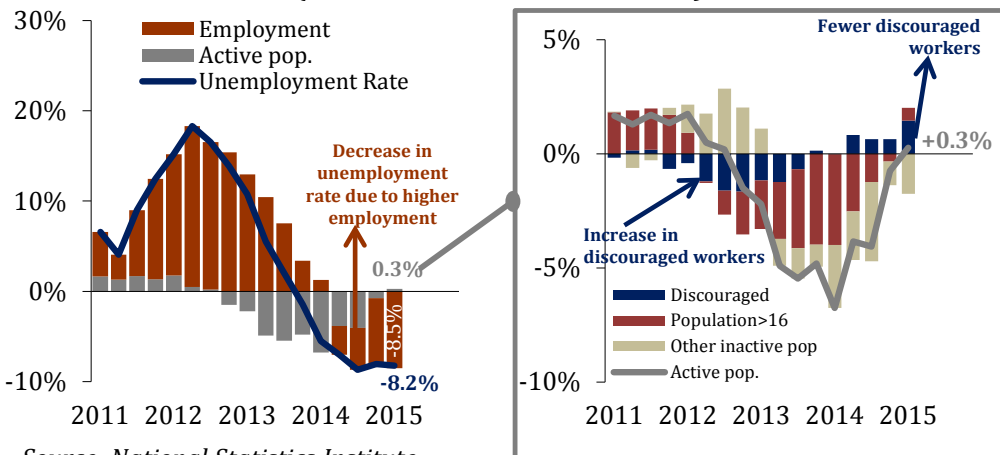
Source: Ministerio de Economía y Competitividad.

The unemployment rate is falling thanks to broad-based expansion

- ▶ Employment creation is broad-based across a series of economic branches and spreading through secondary and tertiary sectors
- ▶ The improvement is especially intense in Manufacturing, Accommodation Services, Professional, Scientific & Technical activities
- ▶ Unlike in late 2013, the fall in the unemployment rate is now mainly explained by employment creation and not by a decline in active population

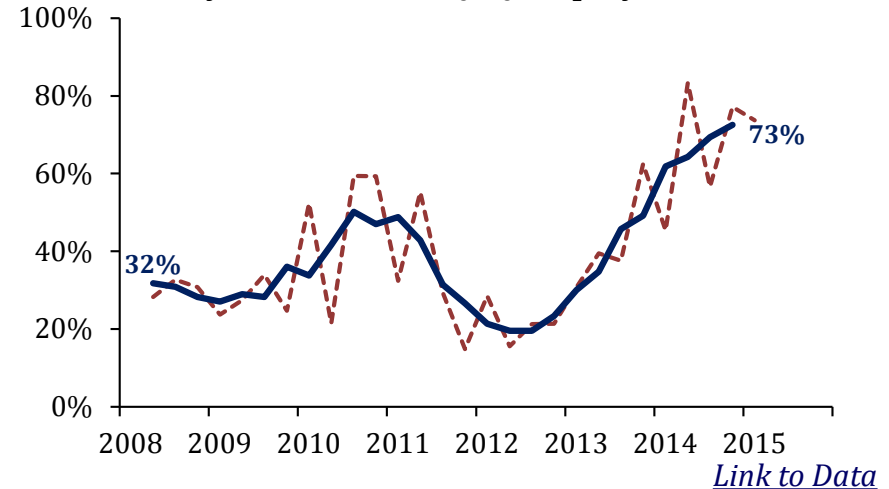


Breakdown of the Growth Rate of Unemployment into Changes in its Components: Active Population and Employment (Year-on-Year Growth Rates)



Source: National Statistics Institute.

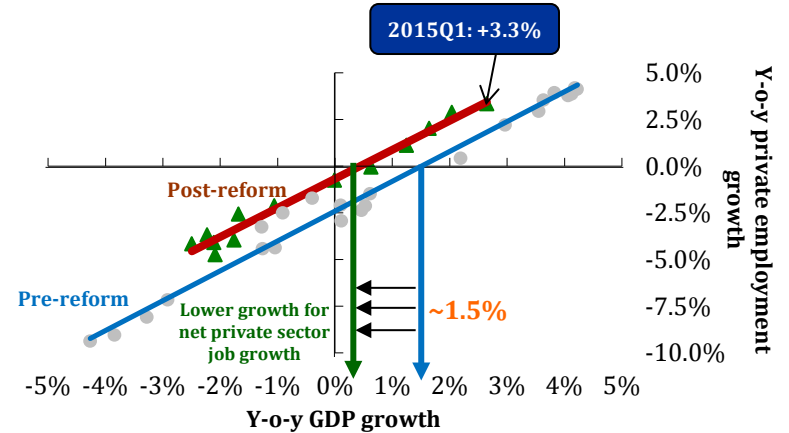
Weighted Average Percentage of Branches of Economic Activity with Positive QoQ Employment Growth



Structural transformation of labour dynamics

- ▶ The labour market reform and the activation policies have positively impacted labour market dynamics. The minimum growth needed for net private sector job creation has declined, while productivity growth has stabilised → the lag between GDP growth and employment creation has diminished to one quarter
- ▶ 2014-2015 reforms of the activation policies with special emphasis on productivity, youth and structural unemployment

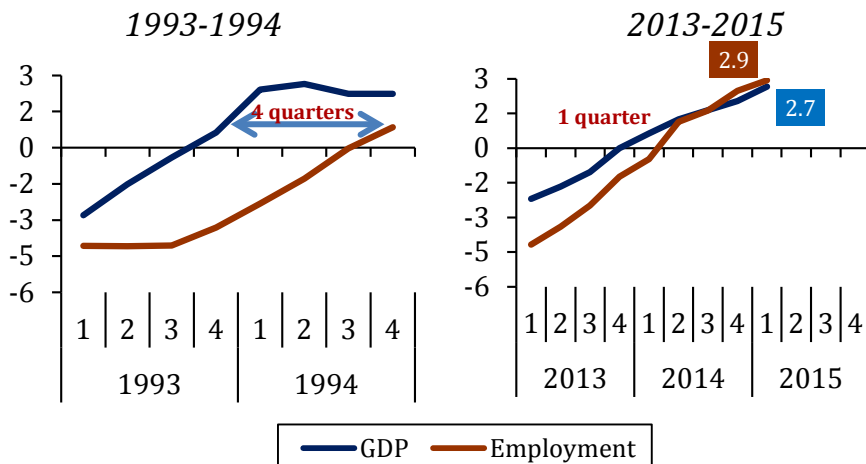
Growth Required for Private Employment Creation (Quarterly Data, Seasonally and Calendar Adjusted)



Source: National Statistics Institute.

[Link to Data](#)

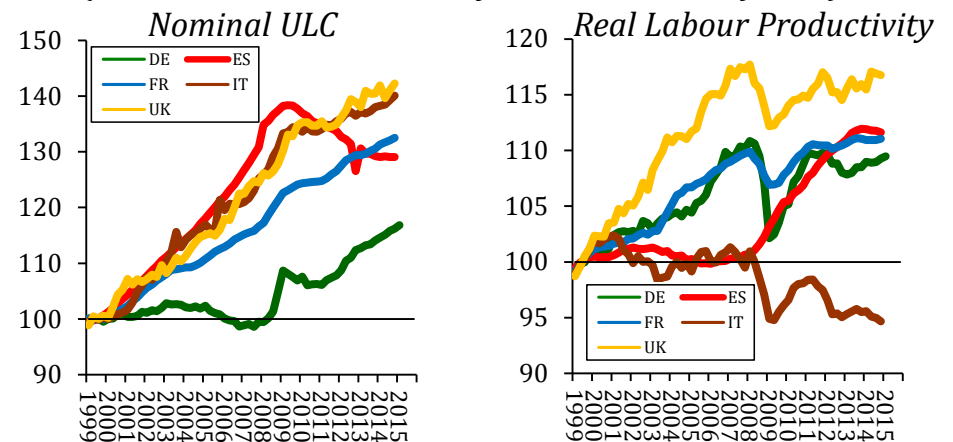
Lag Between GDP Growth & Employment



Source: National Statistics Institute.

[Link to Data](#)

Productivity and Unit Labour Costs (Index 1999=100, Seasonally and Calendar Adjusted)

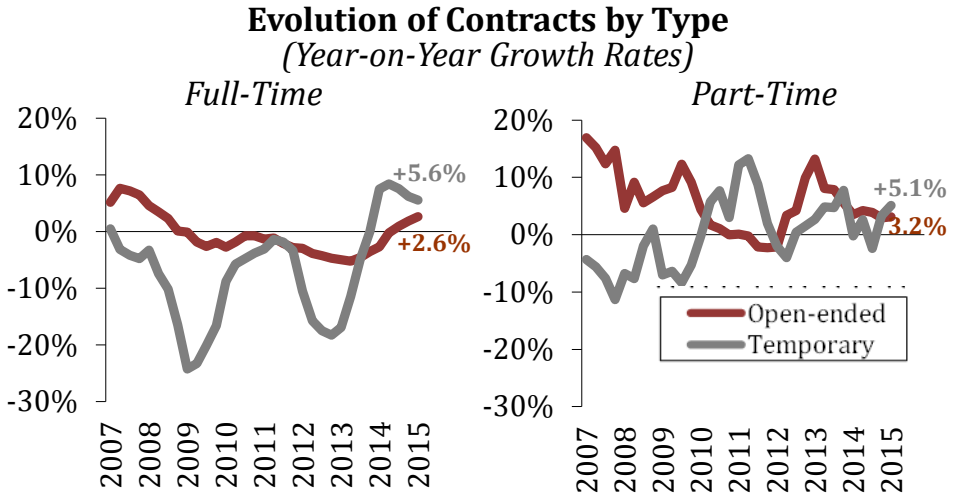


Source: Eurostat.

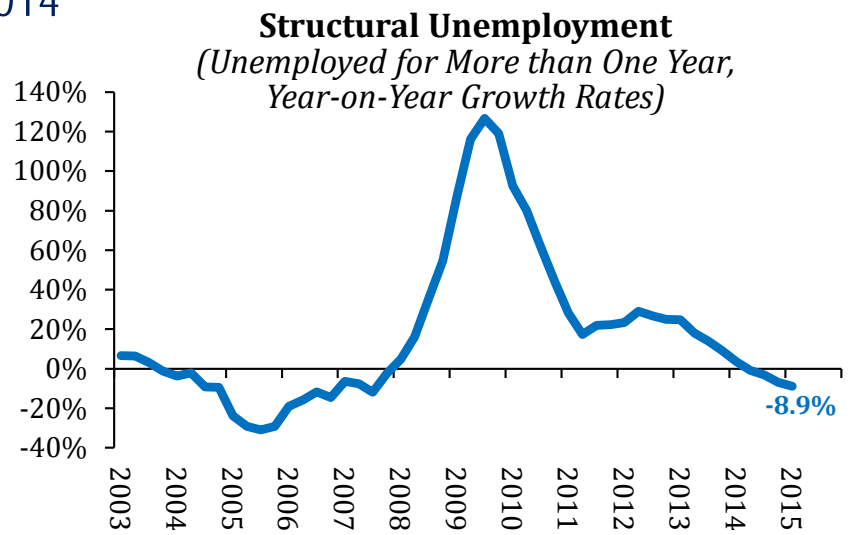
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Recovery of full-time open-ended contracts & declining structural unemployment

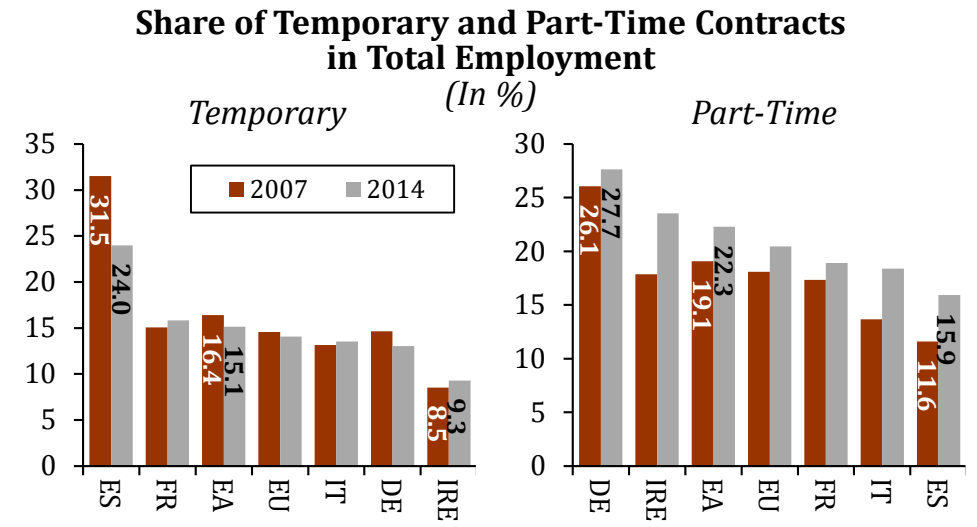
- ▶ Full-time, open ended contracts have increased in the second half of 2014, for the first time since 2008-Q4
- ▶ Share of part-time jobs in total jobs has increased throughout the last years, but still remains well below EU average. In contrast, the share of temporary contracts has declined to minimum levels, but is above EA-average levels
- ▶ Structural unemployment is declining since 2014



Source: National Statistics Institute and Eurostat. [Link to Data](#)



Source: National Statistics Institute and Eurostat. [Link to Data](#)



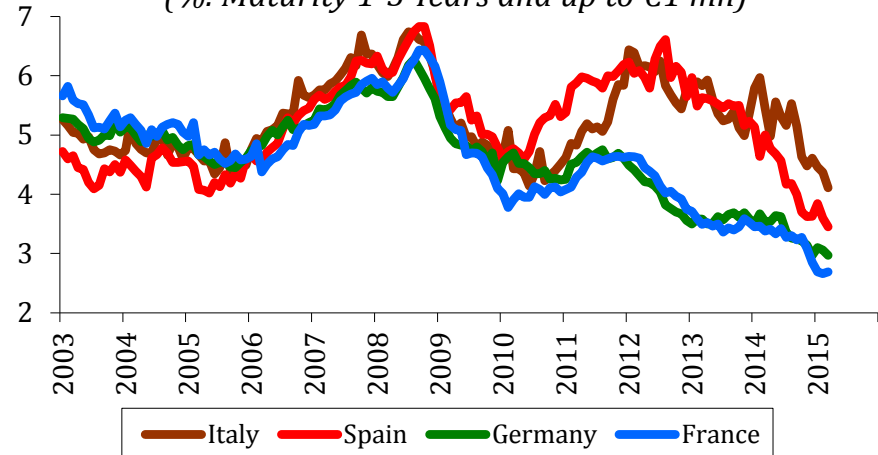
Source: National Statistics Institute and Eurostat. [Link to Data](#)

New credit flows to households & corporates picking up

- ▶ Lending rates for loans up to €1 million have fallen significantly in 2014 and are now much closer to core country levels
- ▶ SME funding and new credit to households continued to improve. Loans for up to €1 million are growing above 10% year-on-year
- ▶ Loans for consumption are growing since 2013 and loans for house purchase since January 2014

Lending Rates of New Loans to Non-Financial Corporations

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

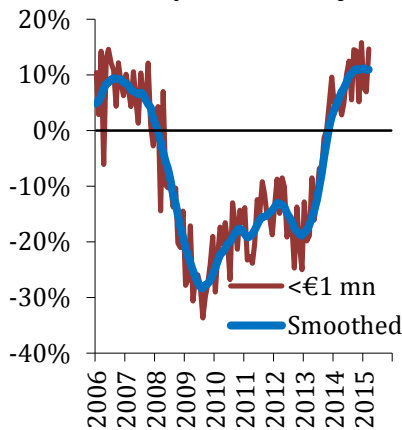


Source: ECB.

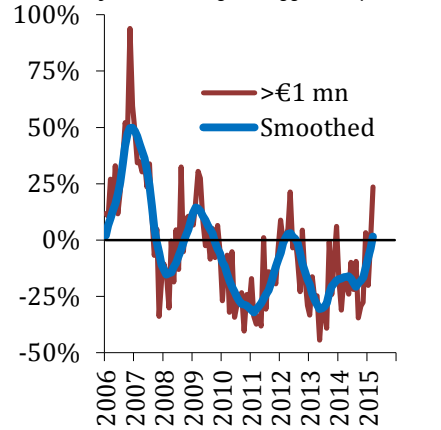
[Link to Data](#)

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

Less than €1 million
(Proxy for SME Funding)



More than €1 million
(Proxy for Funding to Bigger Corporates)

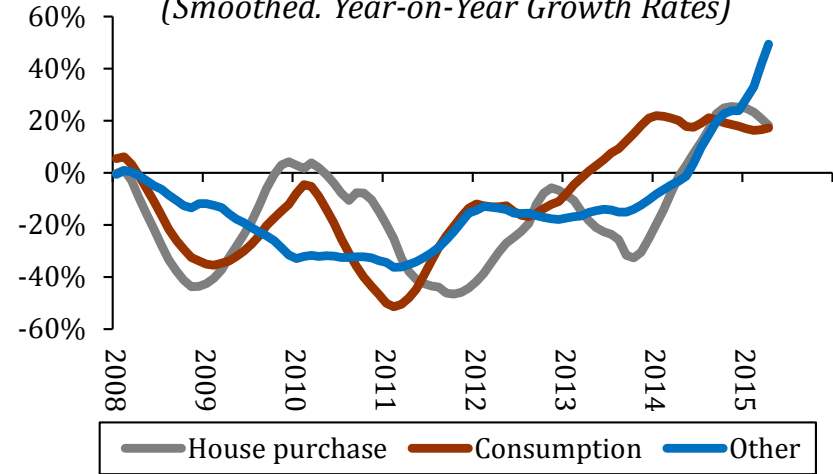


Source: Ministerio de Economía y Competitividad.

[Link to Data](#)

New Credit Flows to Households
By Type of Loan

(Smoothed. Year-on-Year Growth Rates)



Source: Ministerio de Economía y Competitividad.

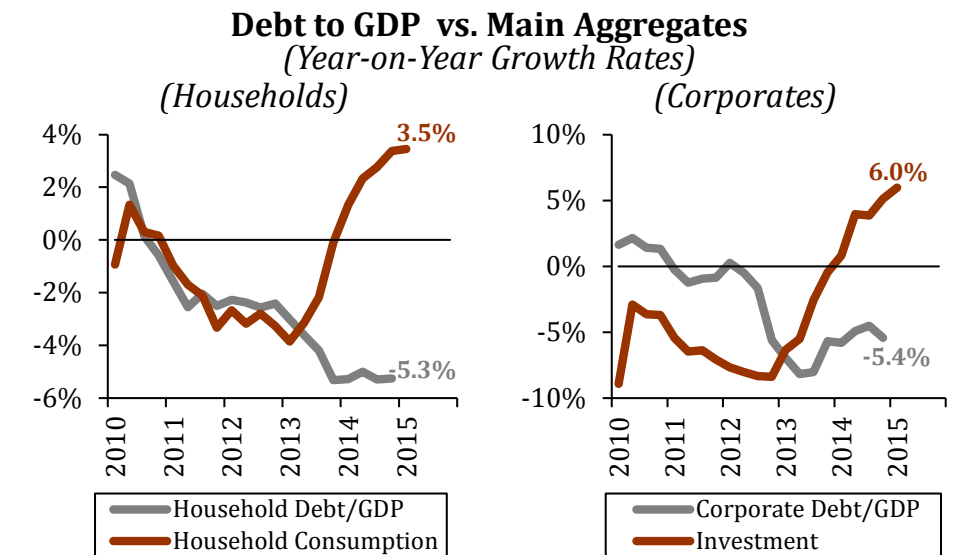
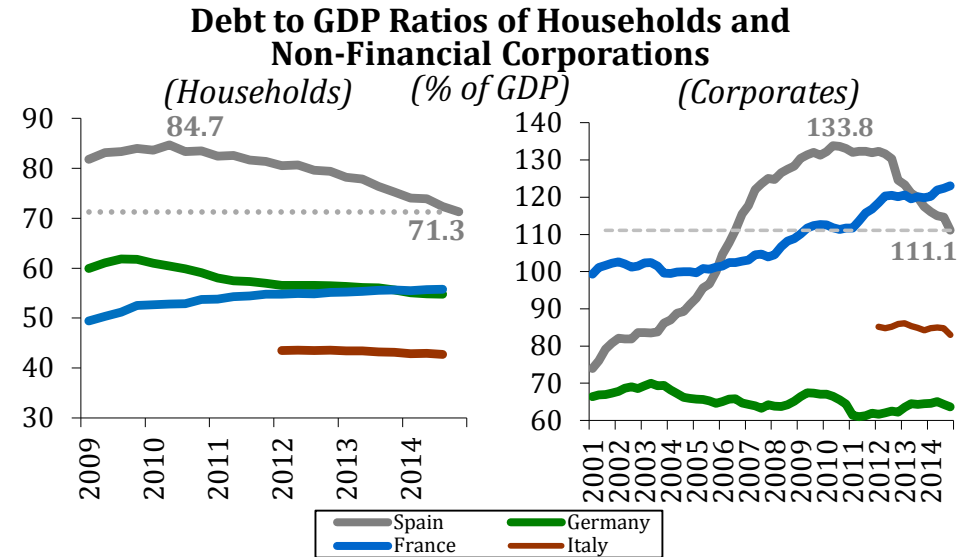
[Link to Data](#)

Deleveraging of the private sector

▶ Since 2010Q2 the private sector has reduced its indebtedness levels by more than €426 bn:

- Firms have reduced their debt stock by €267.3 bn
- Households have reduced their debt stock by €159.1 bn

▶ Despite recent trends in consumption and investment the pace of deleveraging has not diminished; debt to GDP ratios of households and corporations declining at a rate above 5% per year



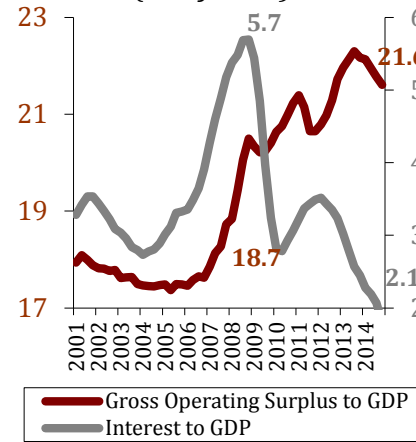
Source: ECB, Bank of Spain and National Statistics Institute.

[Link to Data](#)

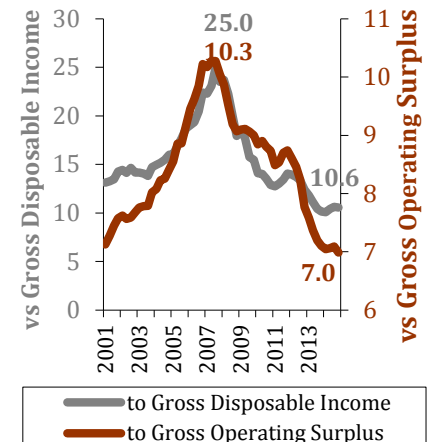
Scenarios for corporate and household debt

- ▶ Firms are generating savings and concentrated on reducing their debt levels. Liabilities to operating surplus below early 2000s level indicates sounder cash-flow environment
- ▶ 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

Gross Operating Surplus and Interest Paid (% of GDP)



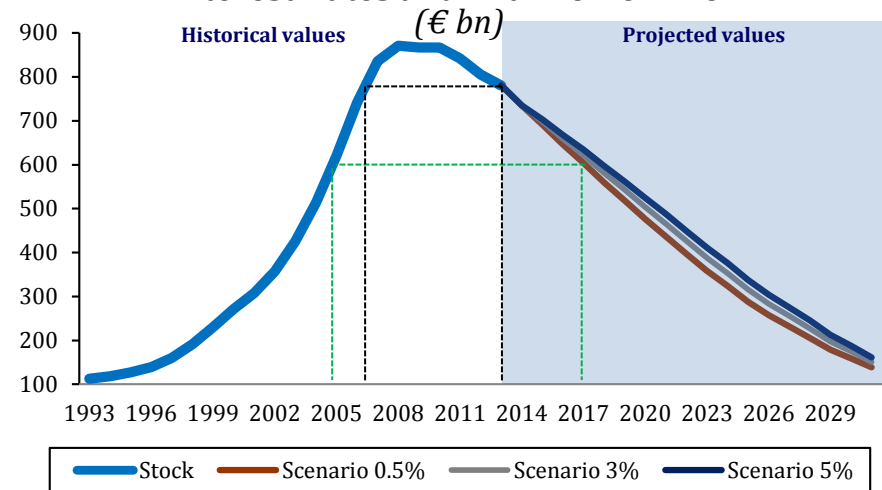
Liabilities Excl. Equity to Gross Disposable Income and Gross Operating Surplus



Source: National Statistics Institute and Bank of Spain.

[Link to Data](#)

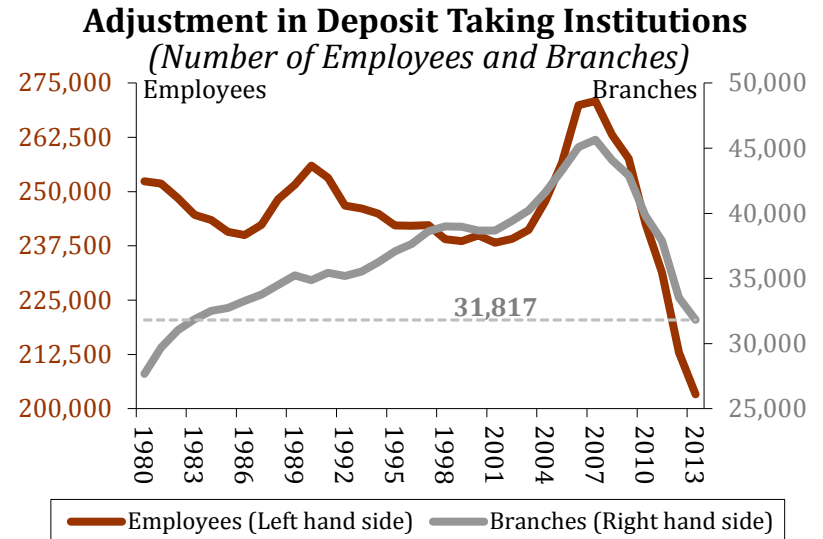
Deleveraging Scenarios of Mortgage Debt at Different Interest Rates and with no New Flow



Source: Santander GBM Research.

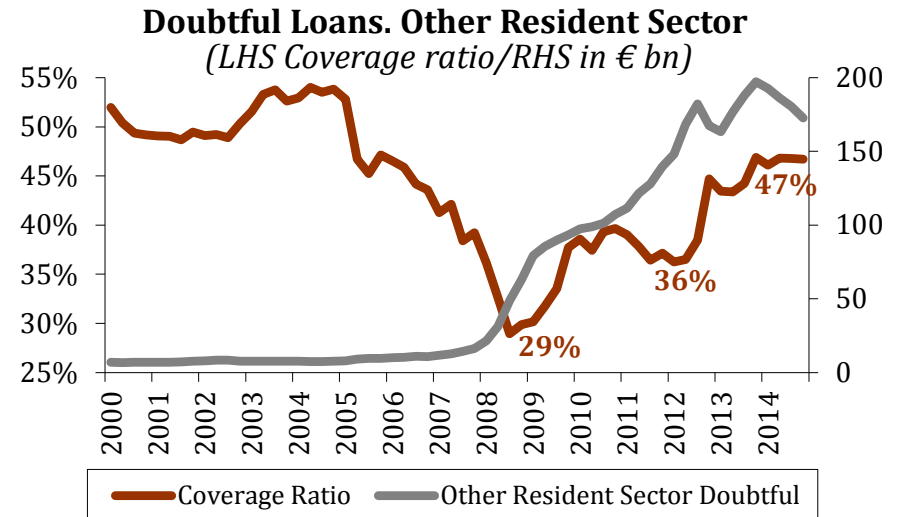
Adjustment and recapitalisation of the financial system

- ▶ 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
- ▶ Coverage ratios of doubtful loans to "other resident sector" has increased from 36% in 2012Q1 to 47% by 2014Q4



Source: Bank of Spain.

[Link to Data](#)



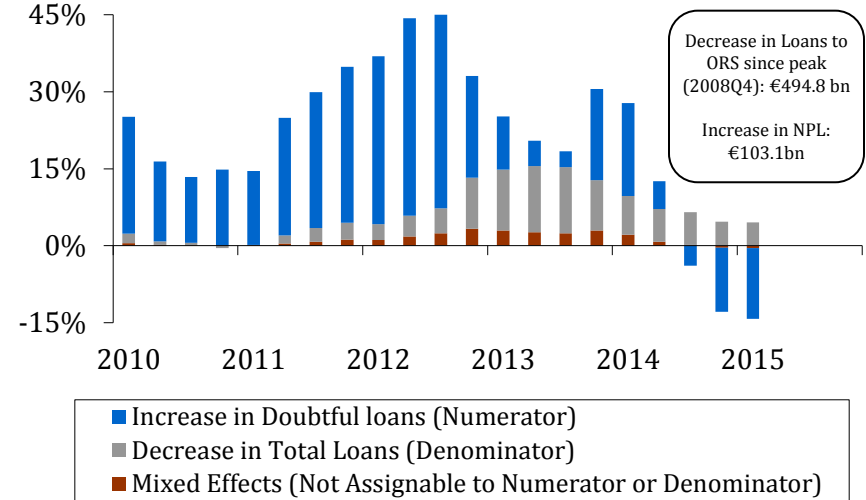
Source: Bank of Spain.

[Link to Data](#)

Adjustment and recapitalisation of the financial system (II)

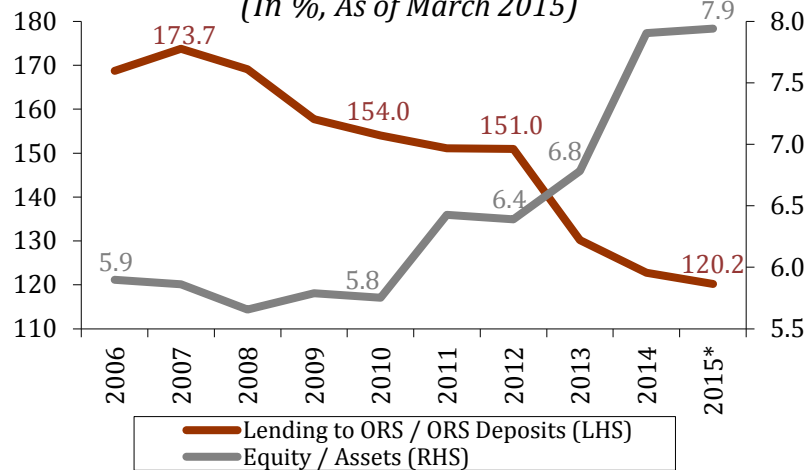
- ▶ Increase in the quality and quantity of information provided by banks, including on refinanced loans
- ▶ Disclosure requirements have been enhanced and harmonised for all entities in key areas of their portfolios such as restructured and refinanced loans, NPLs, asset quality across asset classes, concentration by sector, etc.
- ▶ Doubtful loans declining since 2014Q3
- ▶ Improving equity-to-asset ratio and funding gap

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



Source: Bank of Spain.

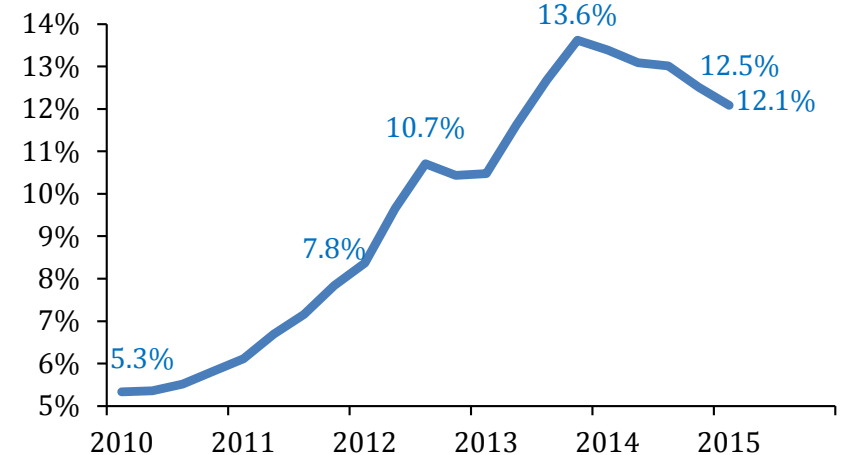
Equity-to-Assets and Lending-to-Deposits Ratios
(In %, As of March 2015)



Source: Bank of Spain.

[Link to Data](#)

NPL Ratio



Source: Bank of Spain.

[Link to Data](#)

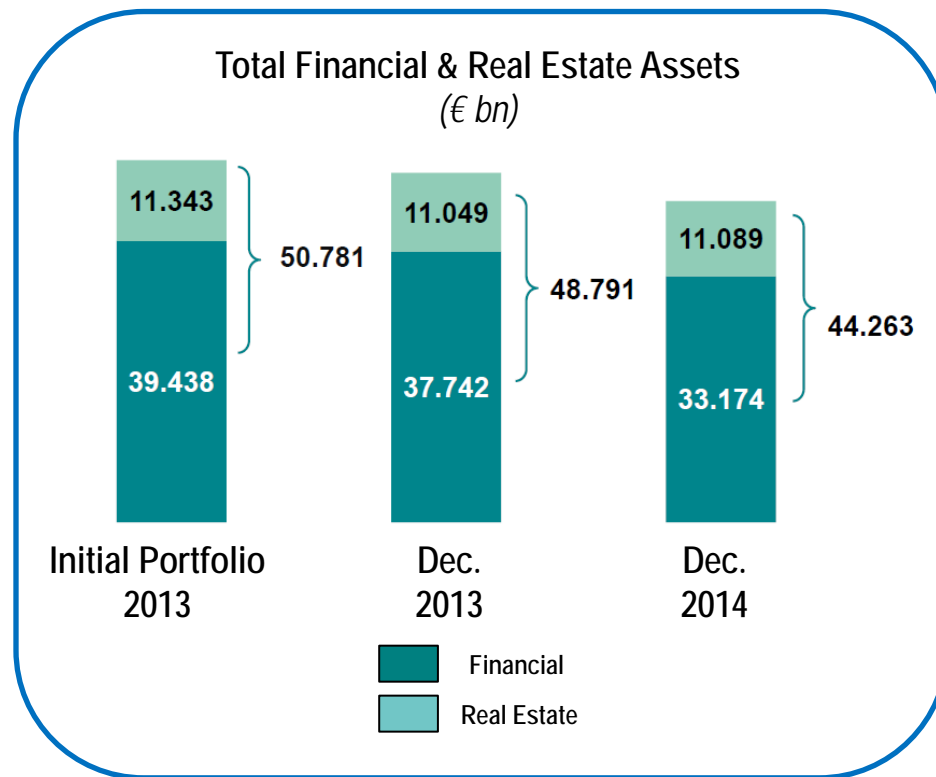
SAREB – asset management company

► Sareb has recently announced the results for 2014, its second full year of activity:

- 24,000 real estate assets sold
- 25 major wholesale operations

► Turnover has increased by 23% to an amount of €5,115 million, reflecting the recent improvement in the housing sector

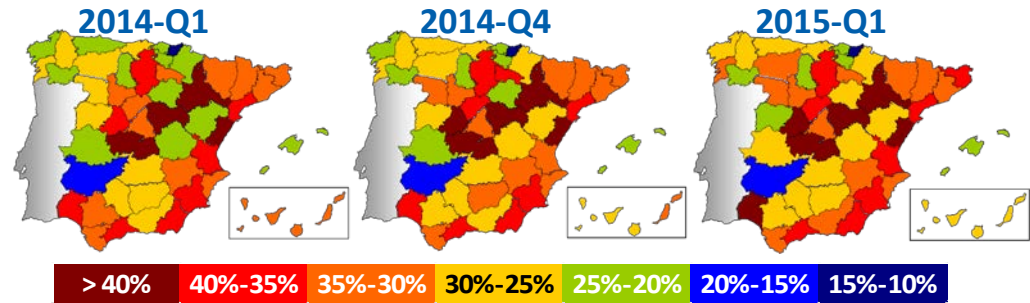
► Redemption of senior debt in 2014 reached €3,400 million; in two years Sareb has written-off a total of €5,4 billion (11%) of its senior debt, which is guaranteed by the State



Incipient recovery in Spain's construction sector

- ▶ Though transaction levels are still modest, the number of transactions of dwellings, as well as mortgages and new loans indicates a rebound from the lows reached in 2013
- ▶ The gross value added generated by the construction sector is expanding since 2014Q2, for the first time since 2008
- ▶ Prices bottomed-out around mid-2014, and have shown a moderate upward trend

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

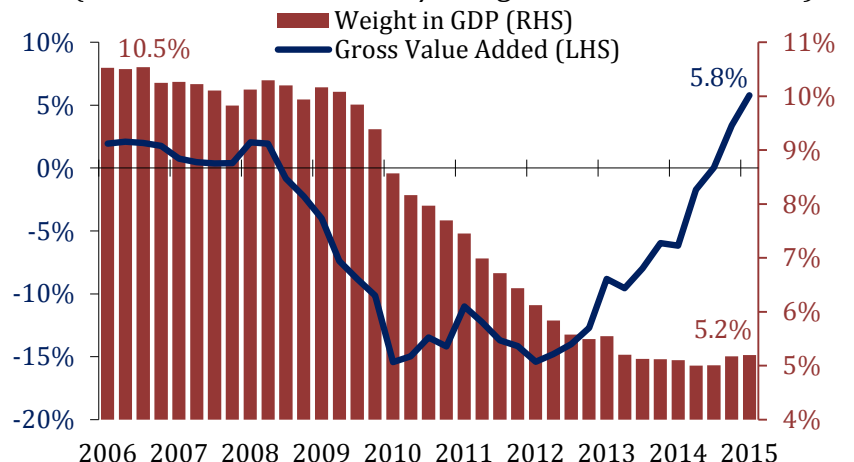


Source: Ministerio de Fomento.

[Link to Data](#)

Gross Value Added in Construction

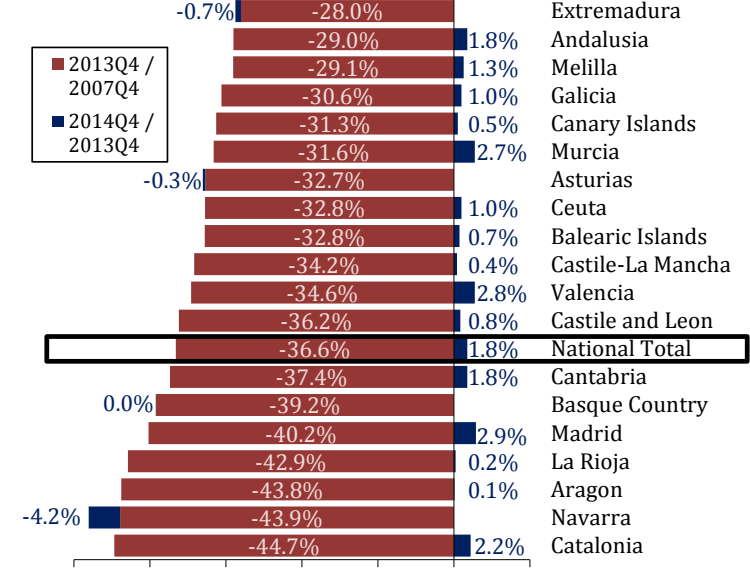
(YoY Growth Rates, LHS / Weight in Total GDP, RHS)



Source: National Statistics Institute.

[Link to Data](#)

House Price Index (Growth Rates)

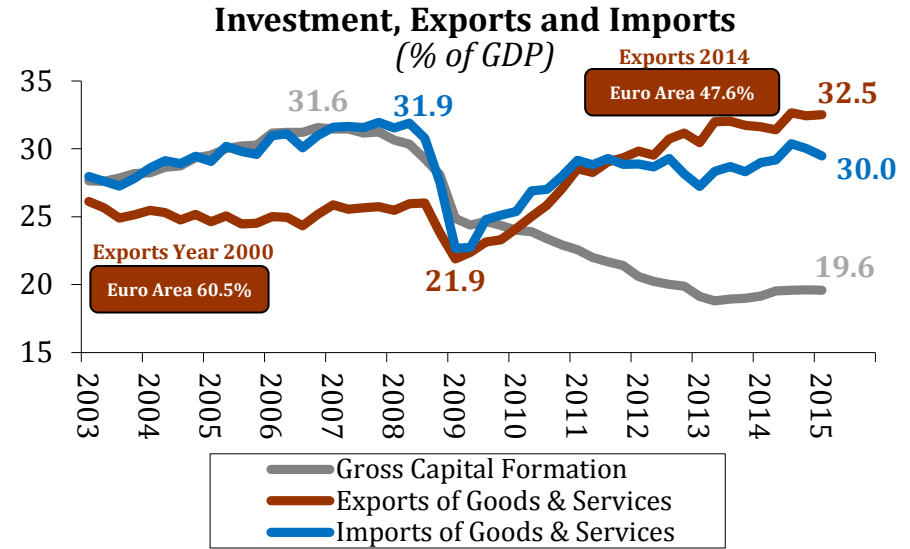


Source: National Statistics Institute.

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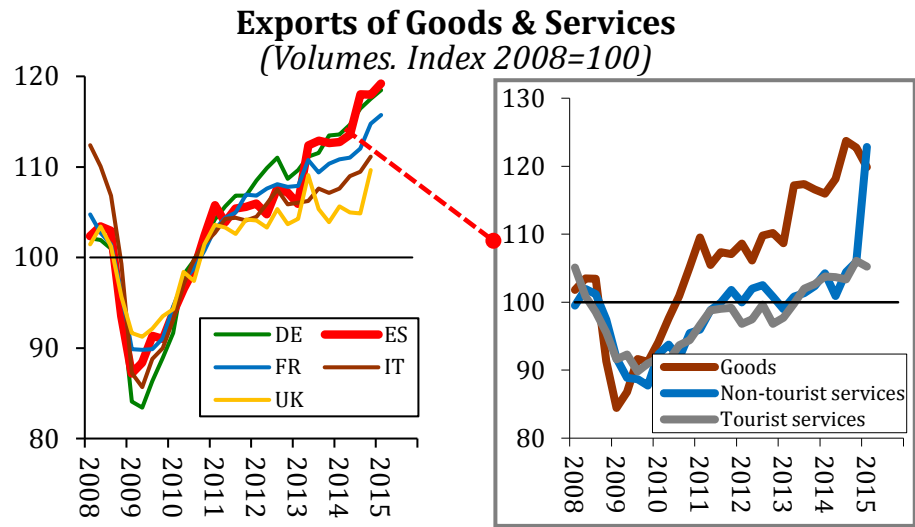
From net borrower to net lender

- ▶ The weight of exports in GDP has increased from 21.9% in 2009Q1 to 32.5% by 2015Q1
- ▶ Investment has stabilised since 2013 but far from 2007 levels: from 31.6% of GDP to 19.6%, converging with Euro Area average
- ▶ The current account has registered its second consecutive yearly surplus in 2014, +0.8 pp of GDP, supported by falling oil prices and accelerating real goods exports +4.2% year on year in 2014



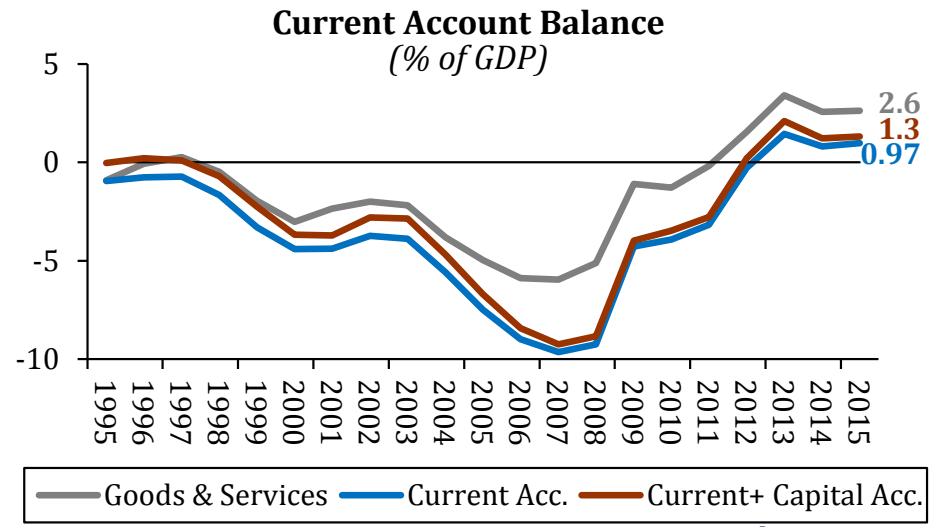
Source: National Statistics Institute.

[Link to Data](#)



Source: Eurostat and National Statistics Institute.

[Link to Data](#)



Source: Bank of Spain.

[Link to Data](#)

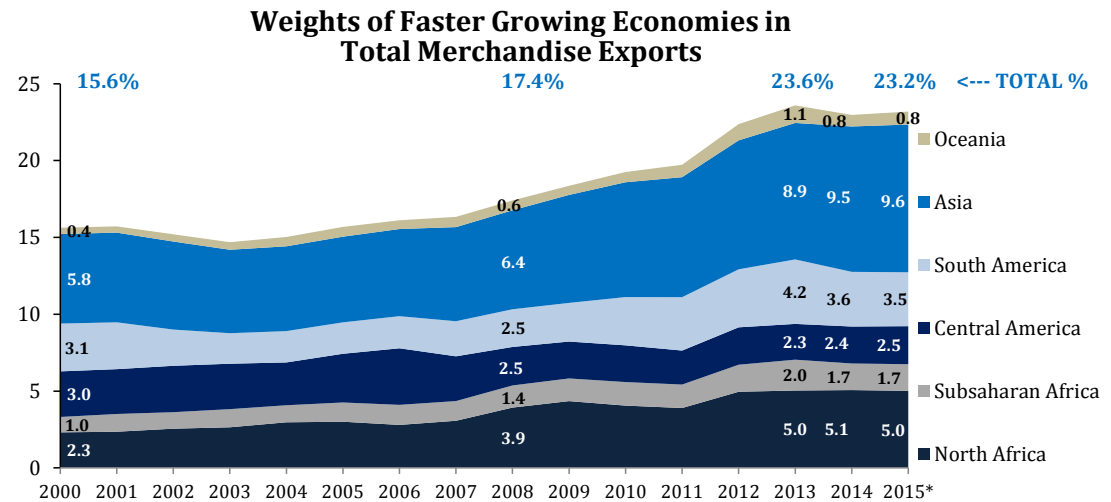
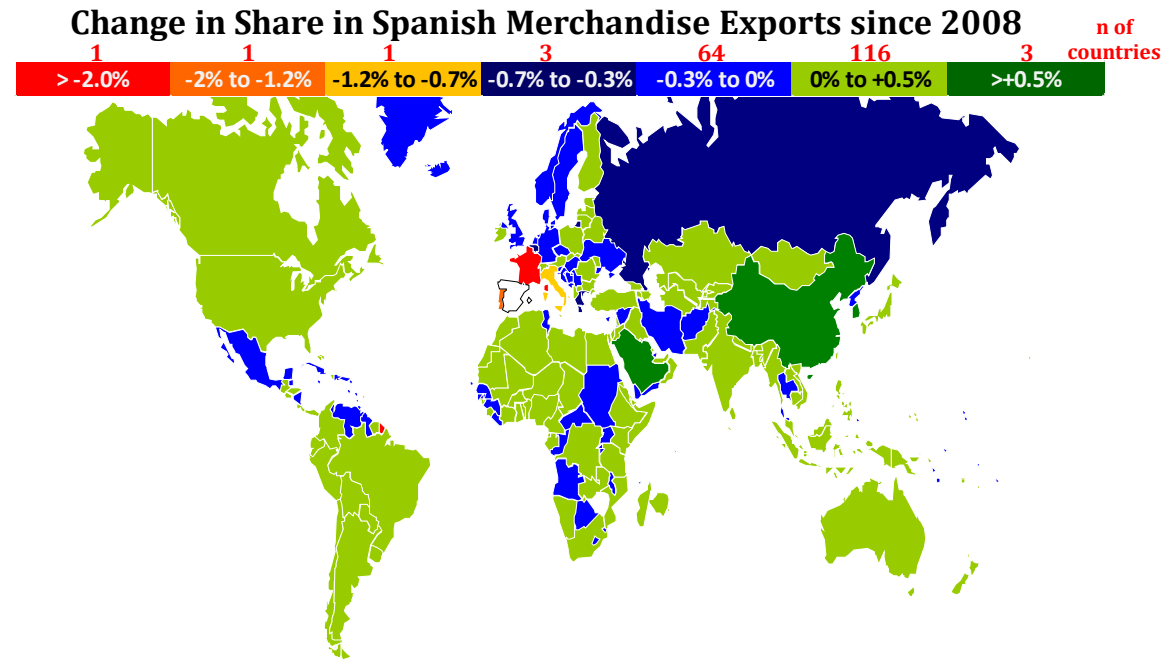
More geographic diversification exports

► In a context of increasing exports, diversification has played an important role

► Increasing share of exports towards Africa, Asia, America and Oceania & lower export share of France, Portugal Italy and Russia

☐ The weight of faster growing economies has increased from 15.6% of total in the year 2000 to 23.2% by March 2015

☐ Merchandise trade to the Euro Area represents 50% (March 2015) vs. 60.5% in the year 2000

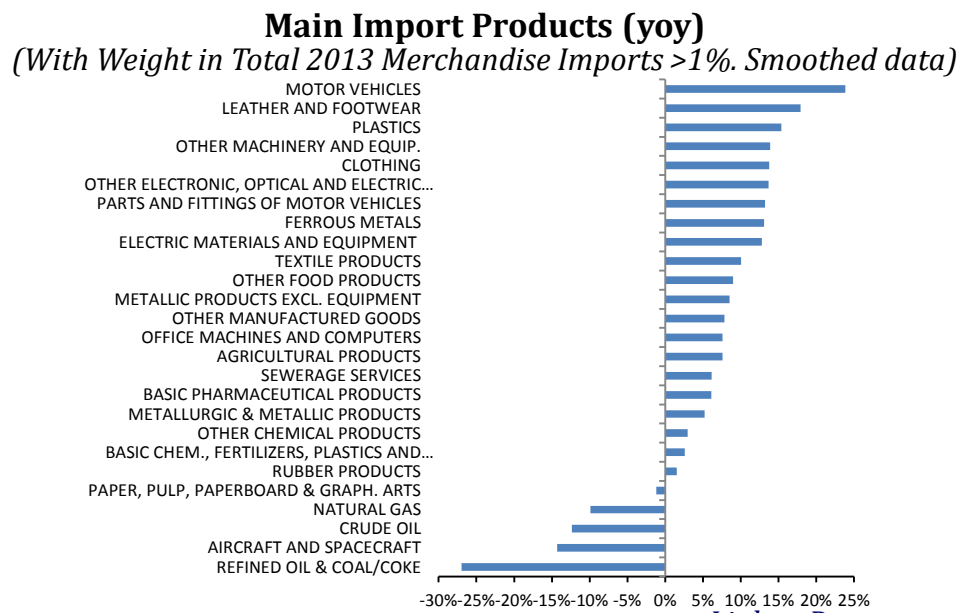
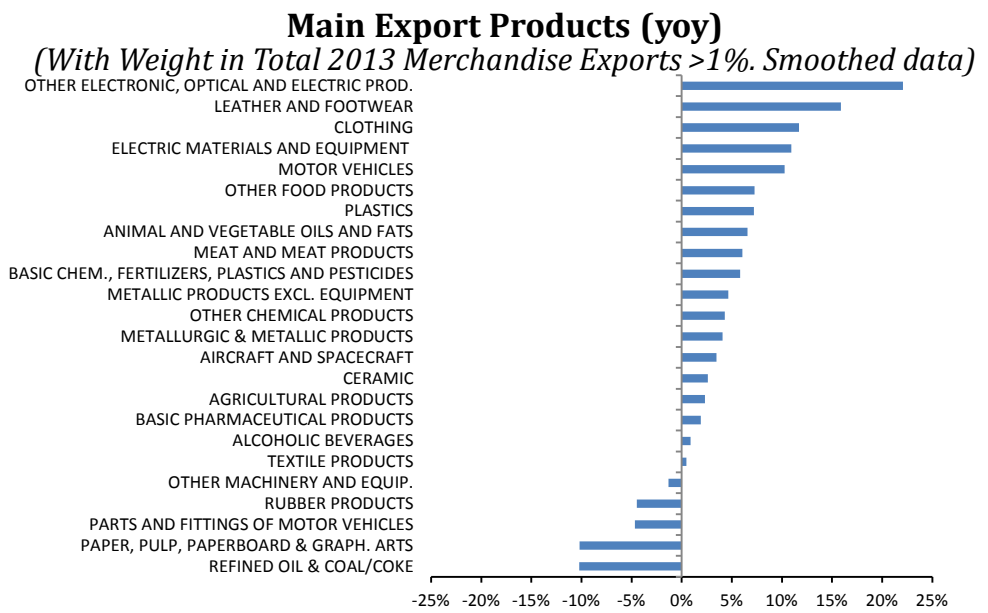
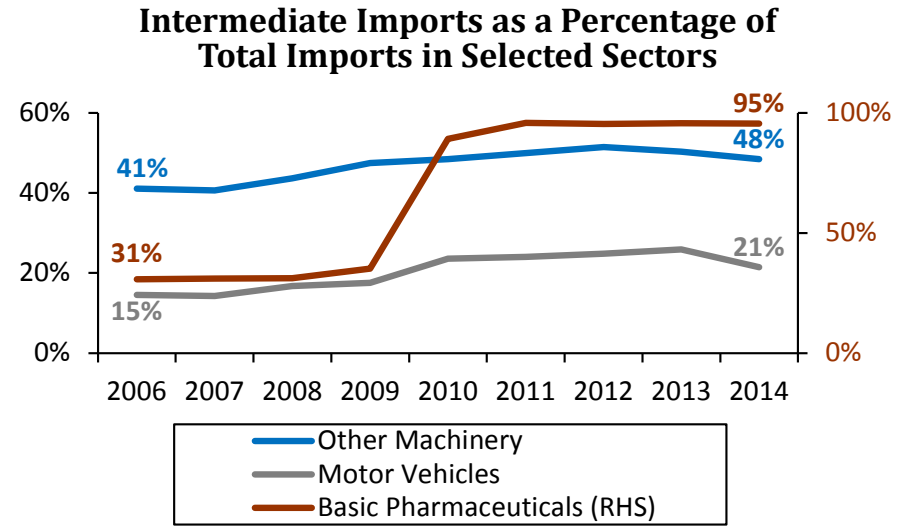


Source: Datacomex.

[Link to Data](#)

Imports of capital goods related to increasing investment & re-exports

- ▶ Large ticket orders in 2013 in specific types of goods (Navantia, Mecca-Medina high speed rail project, etc.) impacted at the beginning of 2014
- ▶ Merchandise imports are a reflection of the impulse in consumption, investment and capacity utilisation in the manufacturing sector (vehicles for professional use, machinery, etc.)
- ▶ Intermediate good intensity of imports signals structural changes in the economy



Source: Ministerio de Economía y Competitividad.

[Link to Data](#)

1. Transformation of Spain's Growth Model

2. Spanish Economic Policy

3. The Funding Programme of the Spanish Treasury

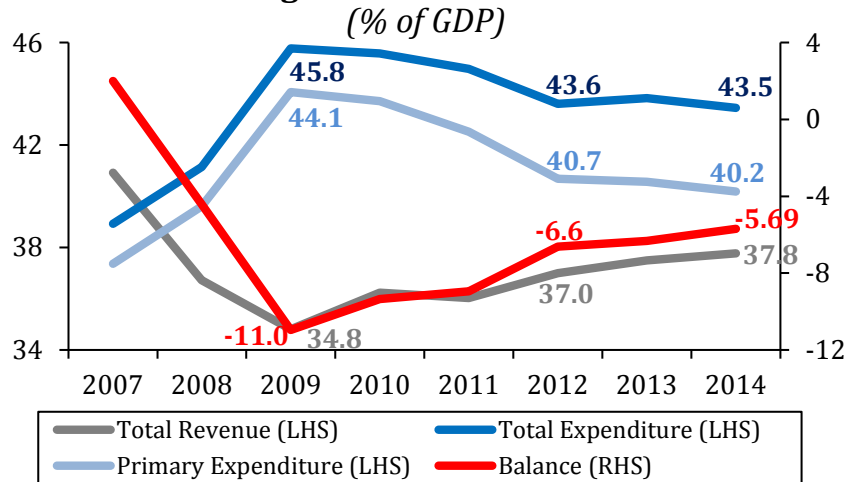
Fiscal consolidation in 2014: efficiency gains & expenditure reduction

► Emphasis on expenditure reduction; mainly driven by efficiency gains in the Public Administrations

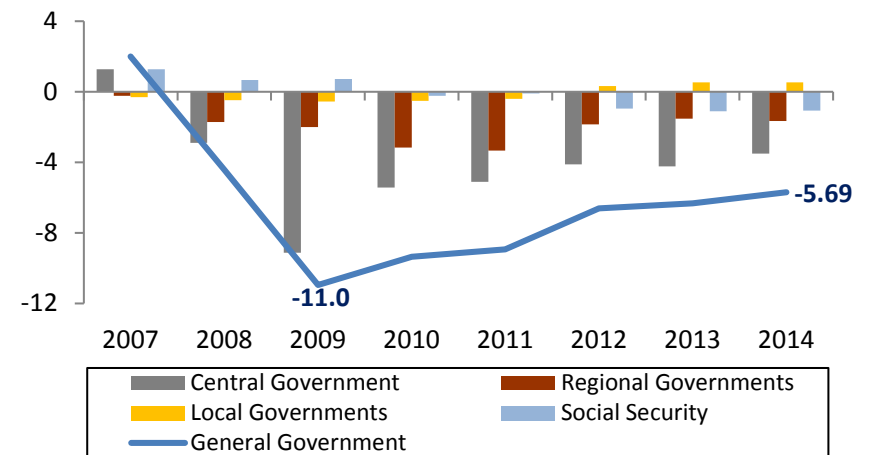
Net Lending(+)/Borrowing(-) (% of GDP)	ESA 2010			
	2011	2012	2013	2014
Central Government	-5.10	-4.12	-4.22	-3.50
Regional Governments	-3.34	-1.84	-1.52	-1.66
Local Governments	-0.40	0.31	0.52	0.53
Social Security	-0.10	-0.96	-1.11	-1.06
General Government	-8.94	-6.62	-6.33	-5.69

Excluding financial sector assistance. 2011 figures exclude 2009 settlements of the Regional Funding System

Revenue and Expenditure of the General Government
Excluding Financial Sector One-Offs



Net Lending(+)/Borrowing(-) by Subsector
(% of GDP)



Source: Ministerio de Hacienda y Administraciones Públicas.

[Link to Data](#)

Fiscal consolidation 2015-2018: no fiscal relaxation

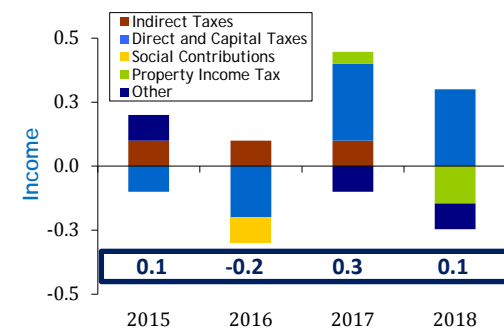
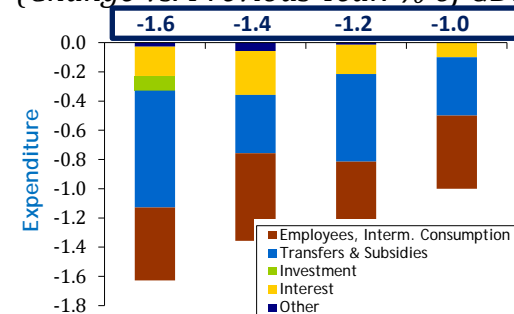
- ▶ 2015 & 2016 deficit targets of 4.2% and 2.8%, respectively, in line with Council Recommendations
- ▶ Despite leaving the Excessive Deficit Protocol, structural adjustment is set to continue in the forecast horizon → no fiscal relaxation

Net Lending(+)/Borrowing(-). (% of GDP). Excl. Financial Sector One-Offs	2014	2015	2016	2017	2018
Central Government	-3.50	-2.9	-2.2	-1.1	-0.2
Autonomous Regions	-1.66	-0.7	-0.3	-0.1	0.0
Local Governments	0.53	0.0	0.0	0.0	0.0
Social Security Administrations	-1.06	-0.6	-0.3	-0.2	-0.1
General Government	-5.69	-4.2	-2.8	-1.4	-0.3

Cyclical Evolution. Including Financial Sector One-Offs	2014	2015	2016	2017	2018
Cyclical Balance	-4.5	-3.2	-2.1	-1.0	-0.1
Cyclically Adjusted Balance	-1.3	-1.0	-0.7	-0.4	-0.2
Structural Balance	-0.9	-0.7	-0.6	-0.3	-0.2
Primary Structural Balance	2.4	2.3	2.3	2.3	2.3

Source: Ministerio de Economía y Competitividad.

Income & Expenditure
(Change vs. Previous Year. % of GDP)



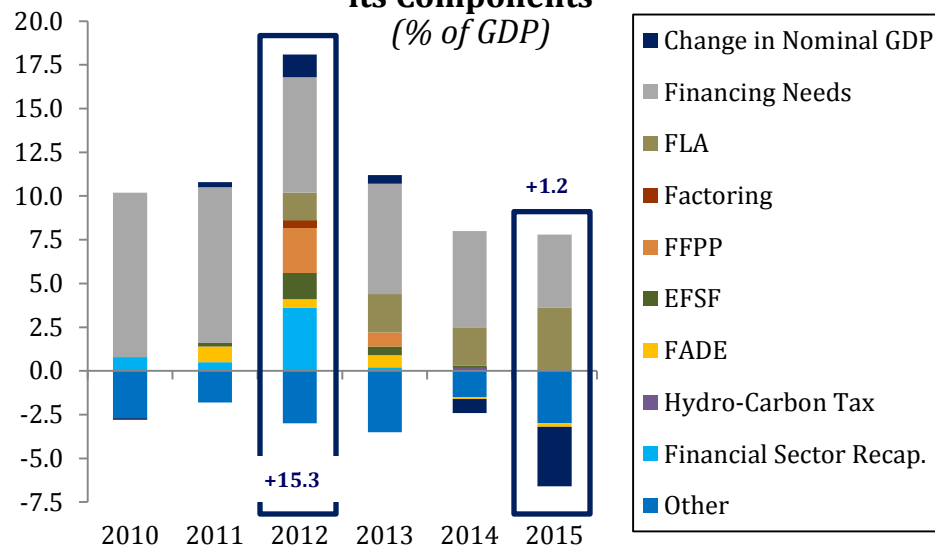
[Link to Data](#)

Debt to GDP path 2015-2018: debt to peak below 100% in 2015

- ▶ Debt to GDP ratio set to peak in 2015 at 98.9%. In 2016 the positive primary balance and nominal GDP growth will cause the ratio to fall below 98.5% of GDP
- ▶ At the end of the forecast horizon, under the baseline scenario, the ratio would progressively fall to 93.2% of GDP

Debt to GDP Dynamics (% of GDP)					
	2014	2015	2016	2017	2018
Central Government	97.7	98.9	98.5	96.5	93.2
Contributions to Growth in the Debt to GDP Ratio					
Primary Balance (incl. Financial Sector)	-2.5	-1.1	0.1	1.2	2.2
Interest Paid	3.3	3.1	2.8	2.6	2.5
Nominal GDP Growth	-0.8	-3.4	-3.7	-4.0	-4.2
Stock-Flow Adjustments	0.6	0.4	0.5	0.6	0.6
<i>Implicit Interest Rate</i>	<i>3.58</i>	<i>3.24</i>	<i>2.98</i>	<i>2.79</i>	<i>2.68</i>

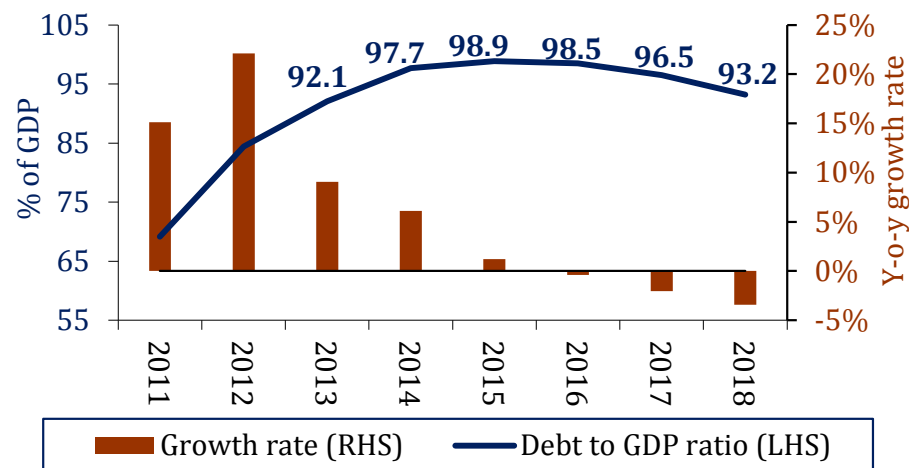
Breakdown of the Change in the Debt to GDP Ratio into its Components (% of GDP)



Source: Ministerio de Economía y Competitividad.

[Link to data](#)

Debt to GDP Ratio (% of GDP and Growth Rate)



Source: Ministerio de Economía y Competitividad.

[Link to data](#)

Budgetary execution in 2015

Monthly budgetary execution highlights:

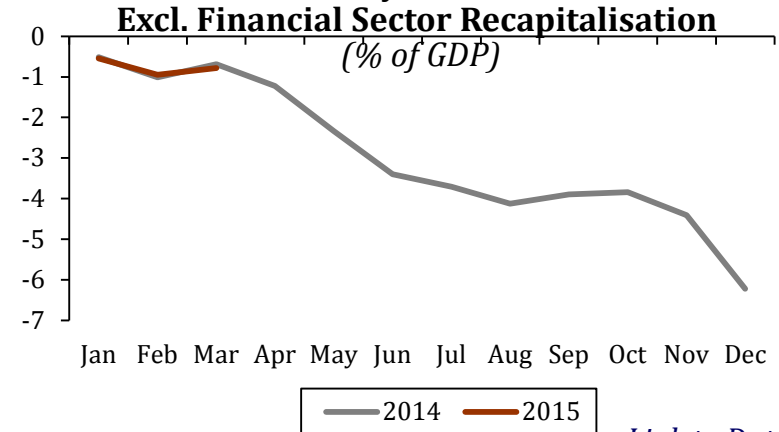
☐ Central Government (March 2015 data): deficit €9.1 bn vs. €7.8 bn by March 2014

- Central Govt. Administration (April 2015 data): deficit €12.0 bn vs. €14.6 bn in April 2014; primary deficit has decreased to €2.1bn, vs. a primary deficit of €4.8 bn by April 2014

☐ Regional Governments (March 2015 data): deficit reached €2.2 bn vs. €2.9 bn by March 2014

☐ Social Security Administrations (March 2015 data): the Social Security posted a surplus of +€2.7 bn vs. +€3.4 bn by March 2014

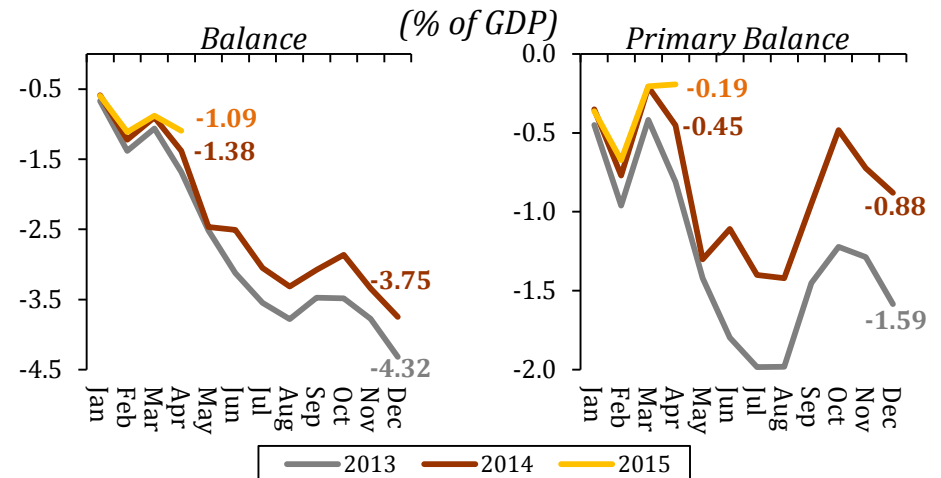
Combined Deficit of Central & Regional Governments and Social Security Administrations.



Source: IGAE.

[Link to Data](#)

Breakdown of the Budget Balance of the Central Government Administration



Source: IGAE.
Up to April 2015

[Link to Data](#)

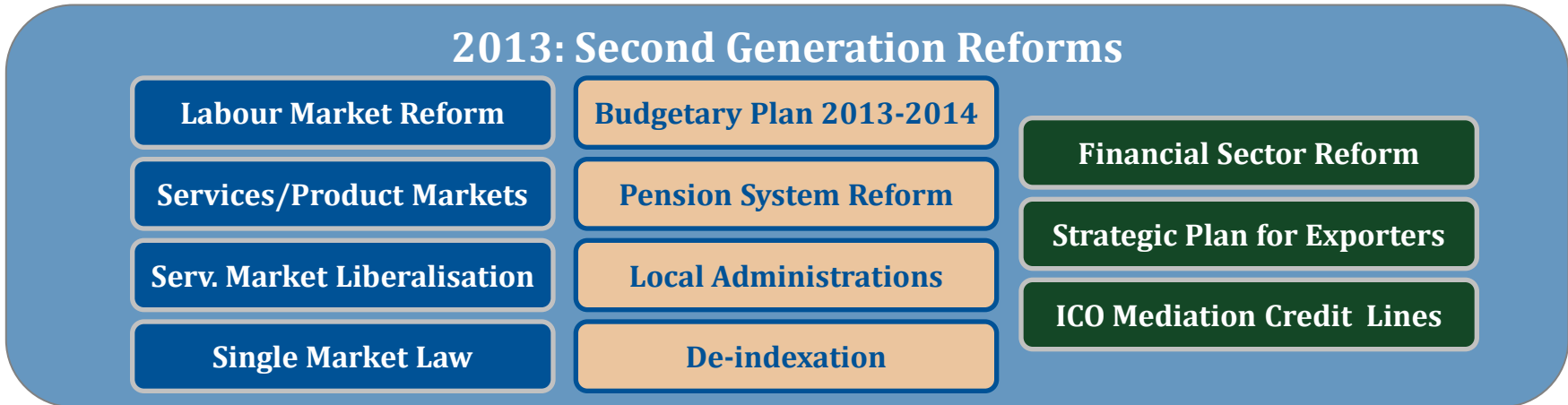
STRUCTURAL REFORMS

Three years of structural reforms

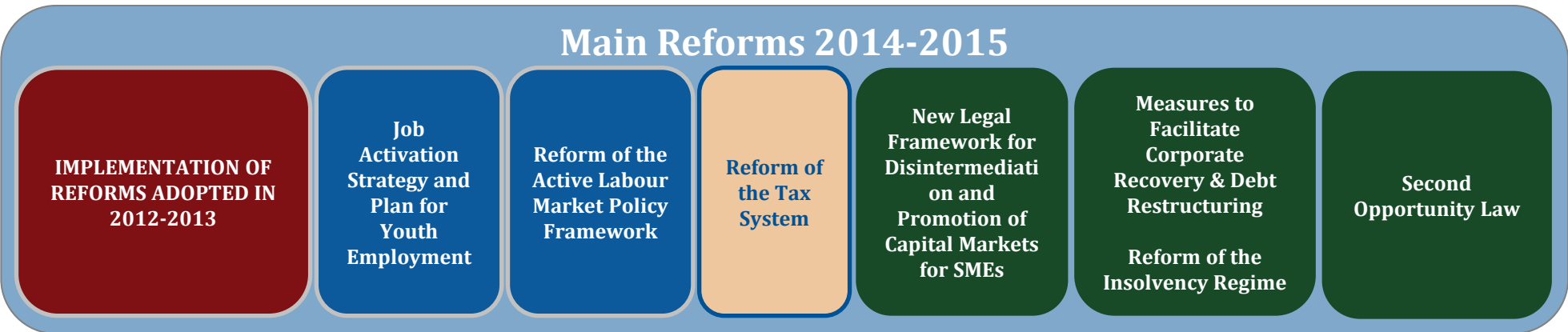
2012: First Generation Reforms



2013: Second Generation Reforms



Main Reforms 2014-2015



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

Links to detailed presentations describing the Reform Agenda

Balance Reforms. Three years in Government
OECD: CORA Reforms

Country Specific Recommendations. June 2014 - March 2015 (I)

Fiscal Budget

1. Reinforce the budget strategy	→ 2015 Budgetary Plan and Fiscal Reform
2. Structural reforms to increase adjustment capacity	→ De-indexation Law
3. Structural Adjustment towards MTO	→ Frontloading of structural effort since 2012
4. Operational Independent Fiscal Authority	→ AIReF operational since 2014
5. Budgetary preventive, corrective and enforcement measures	→ Economic & Financing Plans 2014-2015 // Publication of average payment periods to suppliers
6. Systematic Review of Expenditure	→ Working Group for the Permanent Public Expenditure Rationalisation // CORA Group
7. Rationalisation of Pharmaceutical Expenditure	→ Framework Agreement for Centralised Purchases // Revision of reference prices & improvement in e-administration
8. Reform of the Tax System	→ Approved in 2014, in place since January 1 st 2015 (See slide 24)
9. Reduce tax wedge	→ Social Security contributions' flat rate up to 2015Q1. From 2015Q2 minimum exempt of €500 for permanent hiring
10. Fight against tax evasion	→ Forthcoming CIT Regulation and General Tax Law

Public Administrations

1. Implementation of recommendations of the Committee for the Reform of the Public Administrations	→ High degree of completion. 58% compliance, 129 measures implemented, 93 in execution. Estimated savings in the period 2012-2015: €37,620 mn
2. Transparency in administrative decisions & control mechanisms	→ Transparency law // Draft Organic Law on the Control of Political Parties
3. Monitoring of fight against shadow economy & undeclared work	→ Tax reform // Periodical data on fight against undeclared work // New Law on Labour Inspection to enhance surveillance
4. Adopting pending reforms on the judiciary structure and judicial map; ensuring swift implementation of adopted reforms	→ Draft Law on Voluntary Jurisdiction in Parliament, modifying division of tasks among courts // Reform of the Organic Law of the General Council of the Judiciary Reform of the Code of Civil & Criminal Procedure

Social Inclusion & Poverty

1. Assess and implement National Action Plan on Social Inclusion	→ Specific Projects via the FEAD & EFPC. Spanish FEAD Programme adopted in Dec 2014 // National Strategy for Homeless 2015-2020
2. Administrative coordination between employment and social services	→ Social Inclusion Network establishing protocol for coordination and roadmap for most vulnerable social groups // Assessment of current Basic Income model
3. Targeting of family support mechanisms and quality services	→ 2014 Agreement with employers associations and unions on social inclusion // Roadmap of social and unemployment benefits // New incentives under fiscal reform

Sector Specific Reforms

1. Elimination of the electricity tariff deficit	→ Diverse regulations tackle electricity & gas tariff deficits, especially Law 24/2013
2. Addressing insolvent toll motorways	→ Limitation of contingent liabilities arising from concession contracts & modification of insolvency procedures
3. Independent council to assess major infrastructure projects	→ Council members to be appointed from academia & stakeholders
4. Ensuring effective competition in freight & passenger transport	→ Initial licenses (7 years) partially open up competition in rail transport. After expiry corridor Madrid-Valencia-Alicante-Murcia-Castellon fully opened to competition

Financial Market Reforms

1. Reform of the savings banks	→ Public Hearing of Draft Circular on Savings Banks and Banking Foundations & Development of Corporate Governance
2. Promotion of sustained strong capitalisation of banks and monitoring of SAREB	→ Primary Legislation in place since 2014. Finalisation of the implementation of CRD & Solvency decree in 2015
3. Measures to widen SMEs access to finance	→ Bill on Corporate Financing in last stages of Parliamentary approval // Law on Venture Capital Entities in force // Fond-ICO Global
4. Modifications in the Corporate Insolvency Framework	→ 2014 Reform on the Insolvency and pre-Insolvency proceedings // Further insolvency and tender regulation in H12015

Country Specific Recommendations are published every spring, following months of analysis by the Commission. They focus on what can realistically be achieved in the next 12-18 months in line with the Europe 2020 strategy, the EU's long-term growth and jobs plan

Country Specific Recommendations. June 2014 - March 2015 (II)

Labour Market

1. Reducing labour market segmentation	→ Social Security contributions' flat rate up to 2015Q1. From 2015Q2 minimum exempt of €500 for permanent hiring
2. Regular monitoring of labour market reforms	→ Monitoring shared with EU Commission//ECB//IMF/OECD/ILO
3. Promote real wage adjustment	→ Collective Agreement for Collective Negotiation 2012-2014 supported by 2012 Reform
4. Strengthen linkage between job search and unemployment benefits	→ Extraordinary Activation Programme for long-term unemployed. Conditionality criteria extended to existing subsidies
5. Enhancement of effectiveness and targeting of active labour market policies	→ New active labour market policies // National Youth Guarantee System // Common Catalogue of Employment Services
6. Coordination of training and education	→ Training for the Employment System in force in 2015 // OECD Skills Project // Basic Vocational Education and Training
7. Modernising Public Employment Services	→ 2015 Activation Strategy and Extraordinary Activation Programme for long-term Unemployed
8. Public-private cooperation in recruitment	→ Framework agreement complemented by modifications to private recruitment and interim agencies' legislation
9. Support labour mobility via Single Job Search Web	→ New national Web for employment and self-employment

Youth Unemployment

1. Implementation and evaluation of Youth Entrepreneurship and Employment Strategy	→ National Youth Guarantee System. By Sept 2014 already 33,000 persons registrations
2. Increase outreach of job-offers & apprenticeships + traineeships to non-registered unemployed	→ Temporary hiring incentives extended up to June-2016 // Reinforcement of incentives for apprenticeships & traineeships
3. Reduce early school drop-out	→ In force since 2014.
4. Increased labour market relevance of vocational education and training	→ LOMCE // New Basic Vocational Training // Reform of Intermediate Vocational Training // Evaluation of education and training curricula // Dual vocational training pilot projects

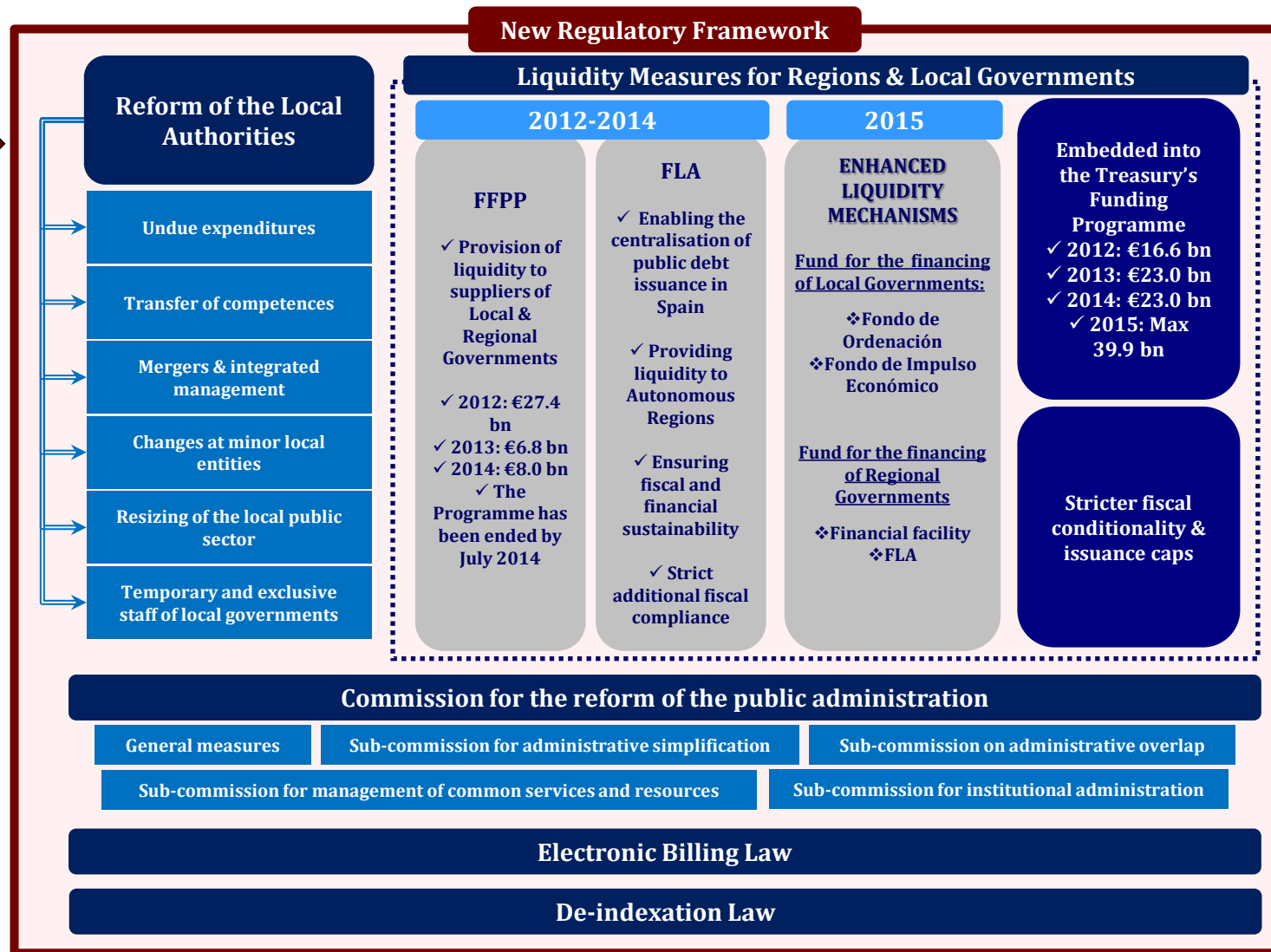
Goods & Services

1. Swift implementation of Market Unity Law	→ <u>A Screening process:</u> ● Central Government; adaptation of 80+ regulations (retail trade, temporary employment agencies, etc.). Further 100 expected to be amended ● Regional screening +400 regulations to be amended <u>B. Single Market Council</u> created in Jan 2015
2. Reduction of time, cost and number of procedures for business creation	→ Entrepreneurship Law. Subnational Doing Business Report conducted by the Worldbank expected by end-2015
3. Revision of existing regional planning regulations	→ Ammendment of Law on Retail Trade // reduction of deadlines for license concessions and introduction of tacit approval principle
4. Identification of new funding sources for the National Strategy for Science, Technology and Innovation and making the State Research Agency operational	→ Plan to Improve Growth, Competitiveness and Efficiency includes, among others, financial instruments managed by ICO, CDTI and public-private projects // Increase in 2015 R&I budget allocation by 4.8%

Country Specific Recommendations are published every spring, following months of analysis by the Commission. They focus on what can realistically be achieved in the next 12-18 months in line with the Europe 2020 strategy, the EU's long-term growth and jobs plan

The reform of the public administrations (I)

► 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
- ▶ In 2015 the liquidity provision by the Treasury to Regions and Local Governments has a limit of €39.9 bn

	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 (€ bn) (2012-2014)	FFPP (€ bn)	TOTAL
Catalonia	25.4	6.6	32.0
Valencia	13.0	7.6	20.6
Andalusia	11.4	5.0	16.4
Castile - La Mancha	3.5	4.0	7.5
Murcia	2.5	1.8	4.3
Balearic Islands	2.6	1.3	4.0
Canary Islands	2.6	0.3	2.9
Madrid		1.3	1.3
Cantabria	0.8	0.3	1.1
Castile and Leon		1.1	1.1
Asturias	0.8	0.2	1.0
Extremadura		0.4	0.6
Aragon		0.5	0.5
La Rioja		0.1	0.1
Local Governments		11.6	11.6

Tax reform: modernising the tax system

- ▶ 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% (out for credit cooperatives and "Cajas Rurales")		▶ Annual publication of tax havens	
▶ Limits to exemptions to severance payments in case of unjustified dismissal	▶ Capital gains generated in less than 12 months no longer penalised		▶ Tax audit process: New deadlines and suspension of Statutes of Limitation in specific situations		
▶ 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 from capital gains tax	▶ Update and simplification of depreciation tables	▶ 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	▶ 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 <ul style="list-style-type: none"> ● New deductions (favouring the deleveraging process): - Capitalisation reserves. 10% of corporate income deductible if incorporated into reserves. <ul style="list-style-type: none"> - Equalisation reserve for SMEs ● Limits to the financial expenditure deductions (favouring the deleveraging process, reduced to 30% of gross operating profit)
▶ 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		▶ Tax assessment cases are extended to smuggling offenses	
▶ 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	▶ Limit to offset tax losses: 50%/25% depending on revenue in 2015; 60% in 2016 and 70% from 2017 onwards. ▶ To maintain income from the CIT, in 2015 previous measures maintained		▶ Better precision in the indirect assessment regime	
				▶ Interruption of the limitation period of related tax obligations	

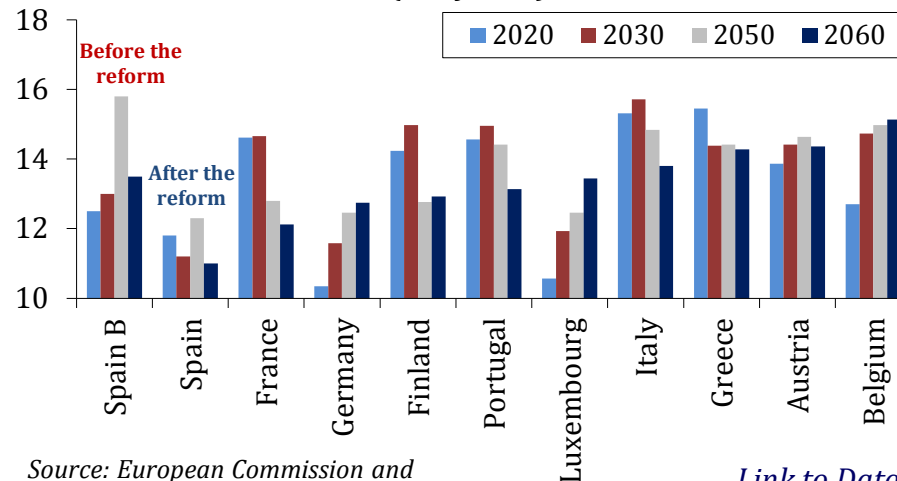
The Pension System reform reduces the impact of population ageing

► In December 2013, the Pension System Reform was approved. It introduced 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 factor; will enter into force in 2019 and will be evaluated every 5 years

► Projections towards 2030-2060 point towards a stabilisation in gross expenditure in public pensions

Gross Expenditure in Public Pensions
(% of GDP)



Source: European Commission and Ministerio de Economía y Competitividad

[Link to Data](#)

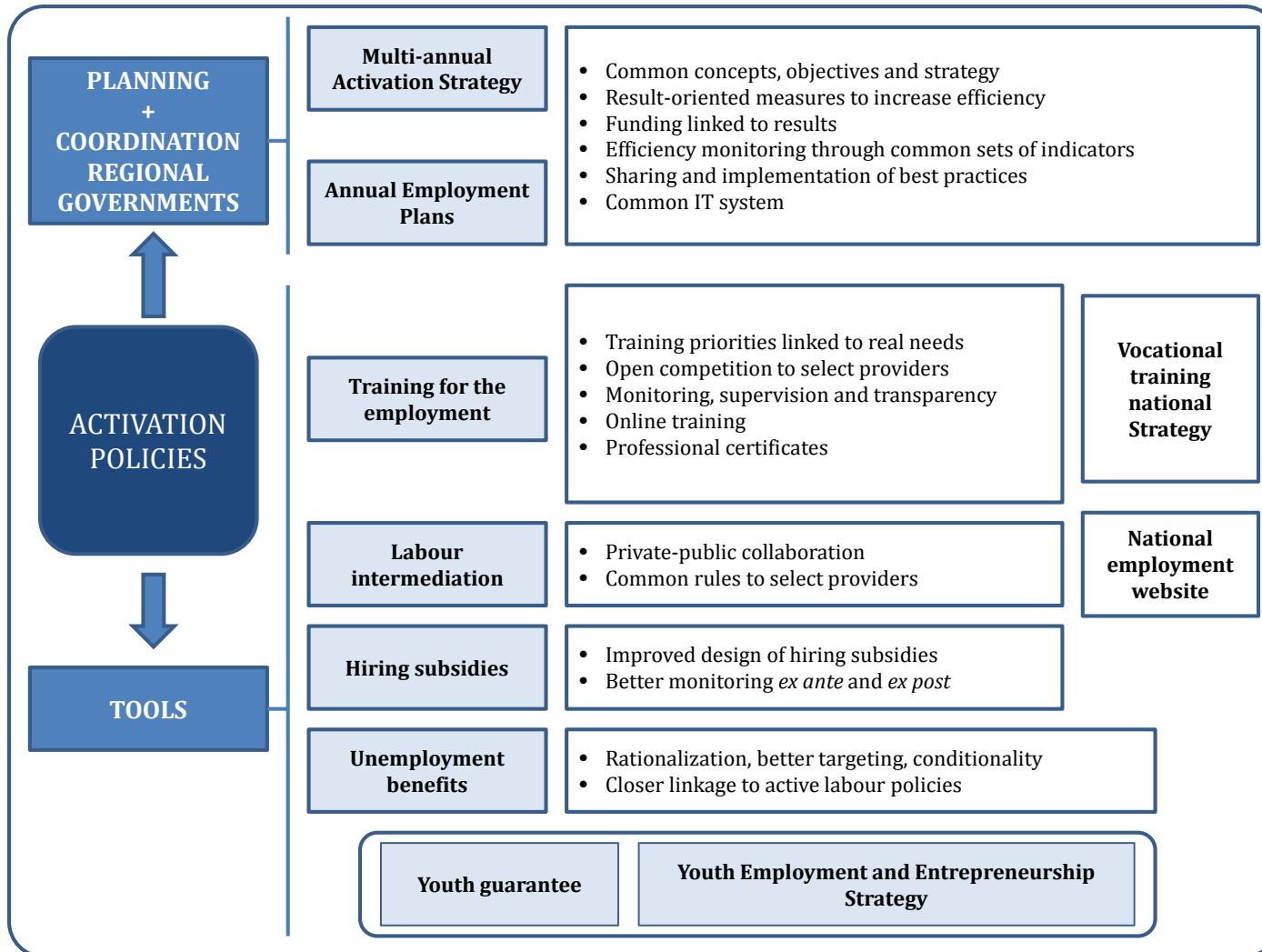
The labour market reform addresses Spain's most important imbalance

► 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 	<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"> → Lack of flexibility avoided innovation and gains in competitiveness 	<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 unemployment



1. Transformation of Spain's Growth Model

2. Spanish Economic Policy

3. The Funding Programme of the Spanish Treasury

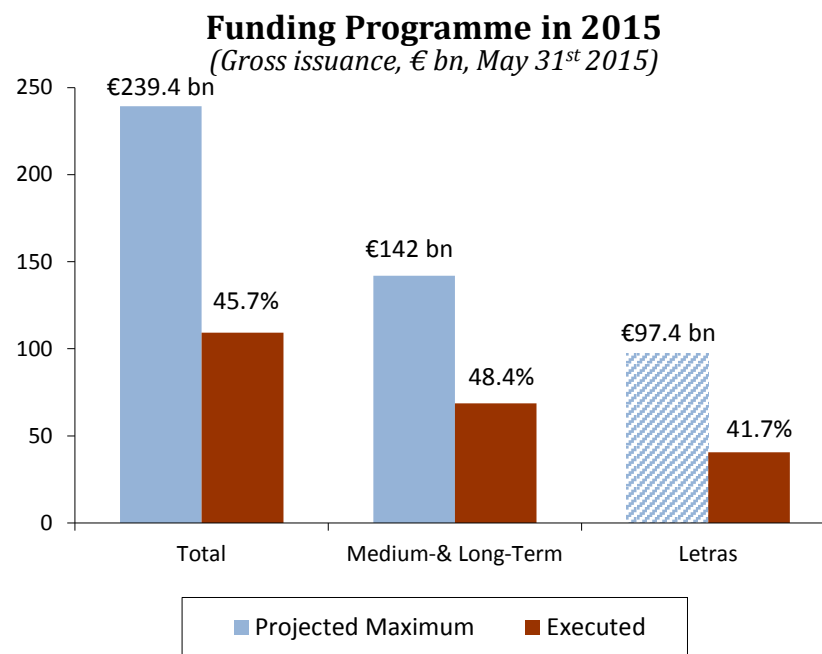
The Treasury's Funding Programme for 2015

- ▶ The net funding target is 55 billion euros, practically identical to that of 2014. This target includes the enhanced liquidity mechanisms for Regions & Local Governments put in place in 2015. Despite having to deal with significantly higher redemption payments of medium- and long-term instruments, total gross funding will be below 2014s.
- ▶ Including Letras, the Spanish Treasury has issued €109.3 bn so far in 2015
- ▶ Up to May 31st the Spanish Treasury has funded €68.7 bn, a 48.4% of the expected amount of the regular medium- and long-term gross issuance, and €40.6 bn, a 41.7% of Letras

<i>(billion euros, in effective terms)</i>	<i>Strategy 2015</i>
Total Net Issuance	55.0
Total Gross Issuance^{1,2}	239.4
Medium- and Long-Term²	
Gross Issuance	142.0
Net Issuance	50.0
Letras del Tesoro	
Forecast Gross Issuance ¹	97.4
Net Issuance	5.0

1 Redemptions of Letras, and therefore also gross issuance, will depend on the Letras issuance strategy in 2015

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



[Link to Data](#)

The Treasury's Funding Programme for 2015

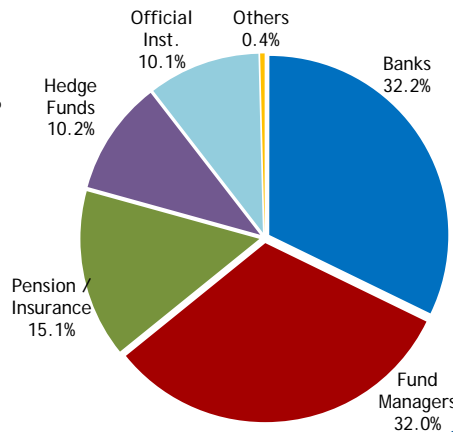
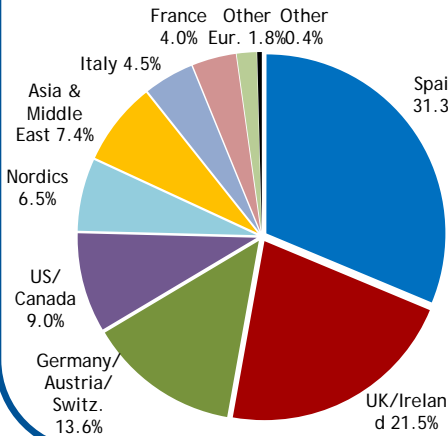
- ▶ The Treasury will cover most of the funding needs of Regions and Local Governments
- ▶ The bulk of the funding programme to be executed via auctions of Letras, Bonos & Obligaciones
 - As a novelty, in the first auction of each month the Treasury might include EA inflation-indexed bonds
- ▶ Issuance via syndications of new 10-, 15- and 30-year references
- ▶ The Treasury is open to the issuance of alternative instruments
 - Medium Term Notes in currency other than the Euro
 - Private Placements via the Primary Dealer's Group: efficiency, size & diversification of the investor base
 - As in 2014, possibility of special auctions
- ▶ Agility in the execution of Letras, Bonos & Obligaciones auctions: issuance range

Syndicated issuance in 2015

JANUARY - NEW 10 YEAR REFERENCE. APRIL 2025

Geographic Distribution (%)

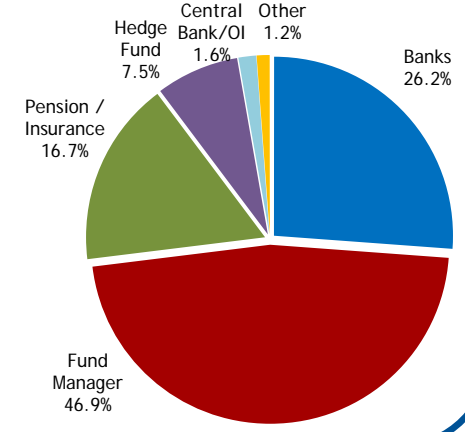
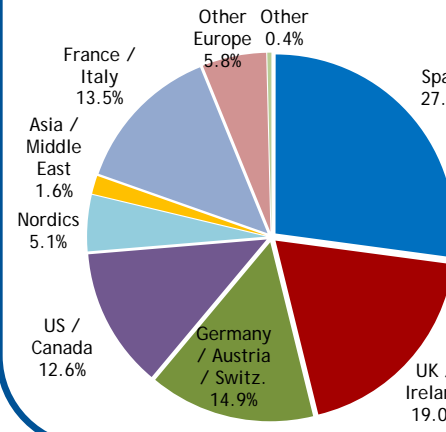
By Type of Investor (%)



FEBRUARY - NEW 15 YEAR REFERENCE. JULY 2030

Geographic Distribution (%)

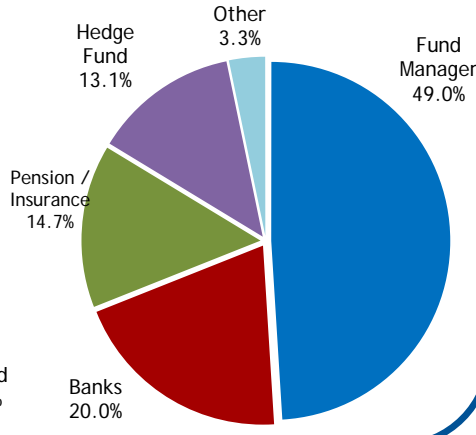
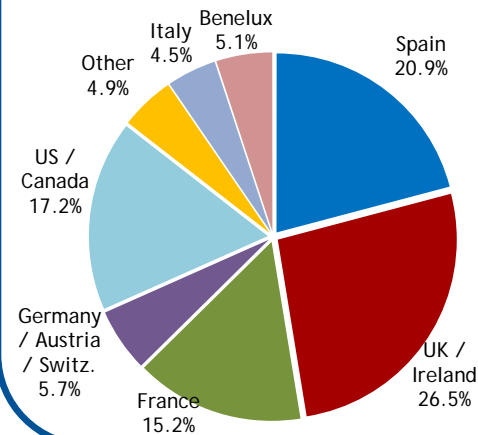
By Type of Investor (%)



MARCH - NEW 15 YEAR EA INFLATION-LINKED REFERENCE. NOVEMBER 2030

Geographic Distribution (%)

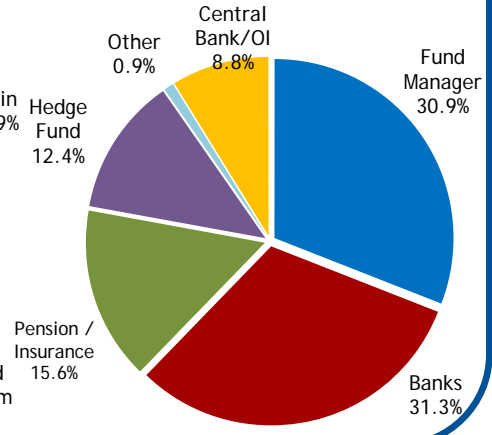
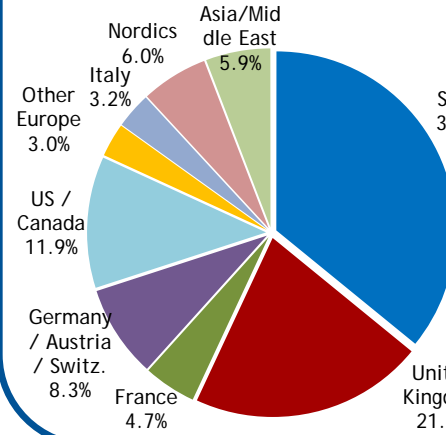
By Type of Investor (%)



JUNE - NEW 10 YEAR REFERENCE. OCT. 2025

Geographic Distribution (%)

By Type of Investor (%)

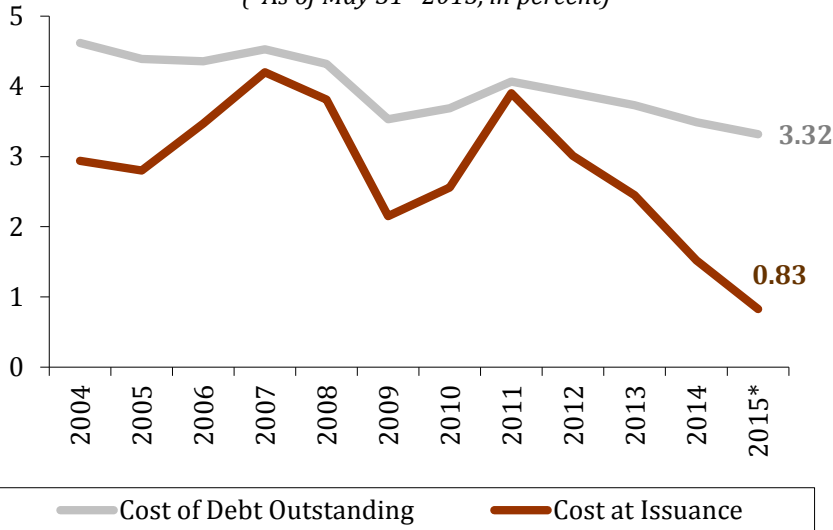


[Link to Data](#)

Cost and life of debt: longer tenors at historically low rates

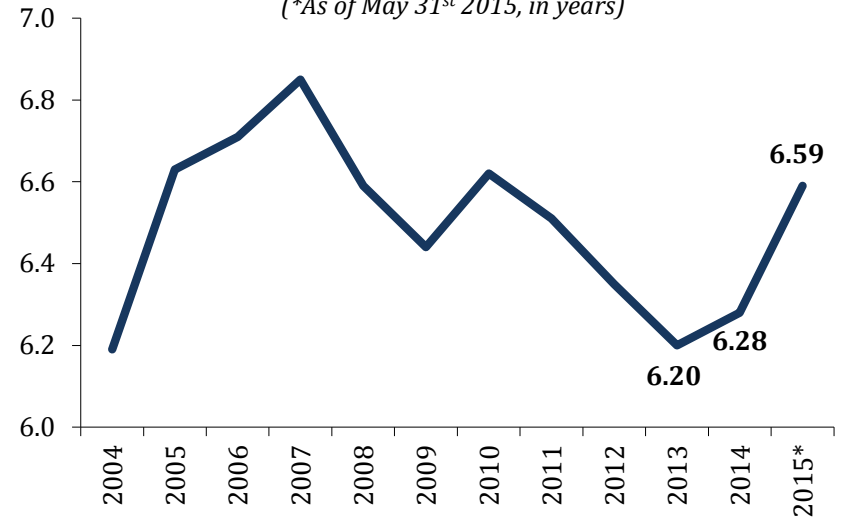
Cost of Debt Outstanding and Cost at Issuance

(*As of May 31st 2015, in percent)



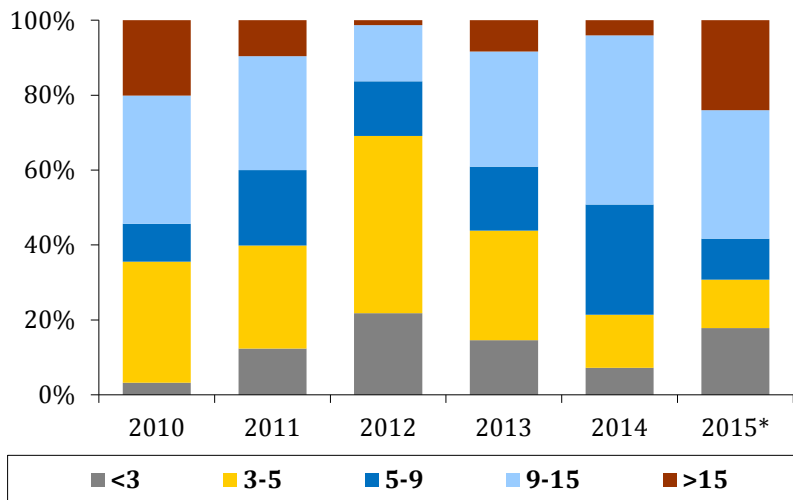
Average Life of Debt Outstanding

(*As of May 31st 2015, in years)



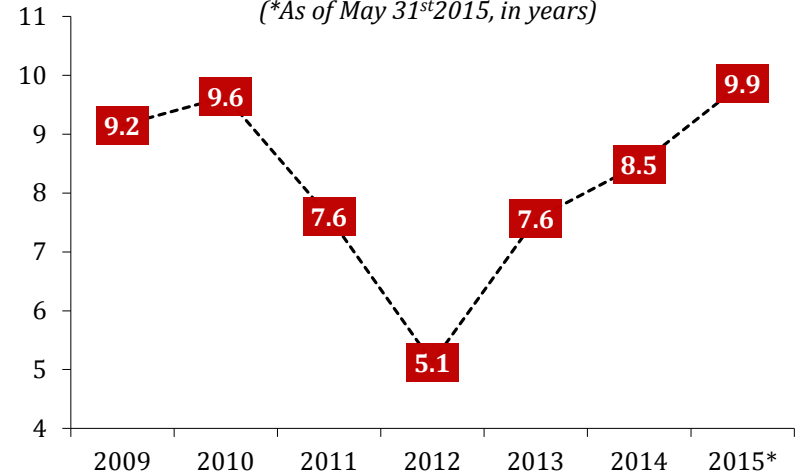
Marginal Life at Issuance of Bonos and Obligaciones

(*As of May 31st 2015, in years)



Average Life at Issuance of Bonos and Obligaciones

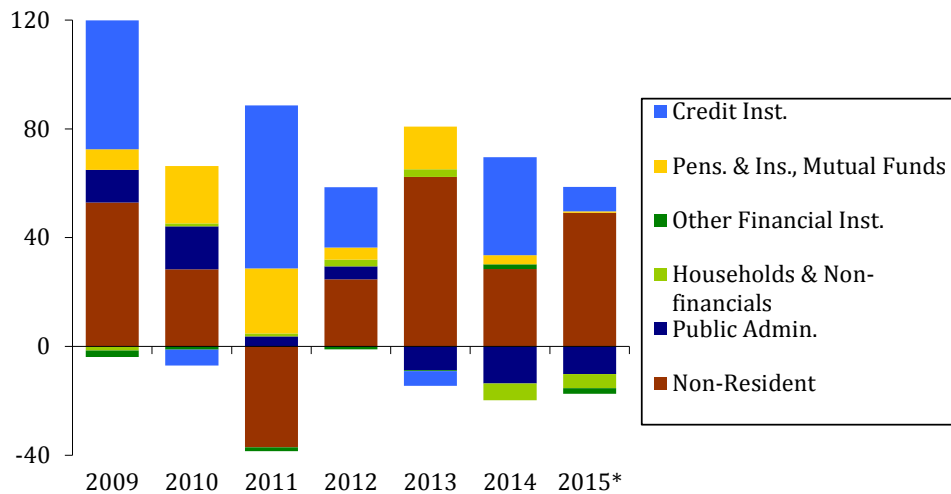
(*As of May 31st 2015, in years)



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

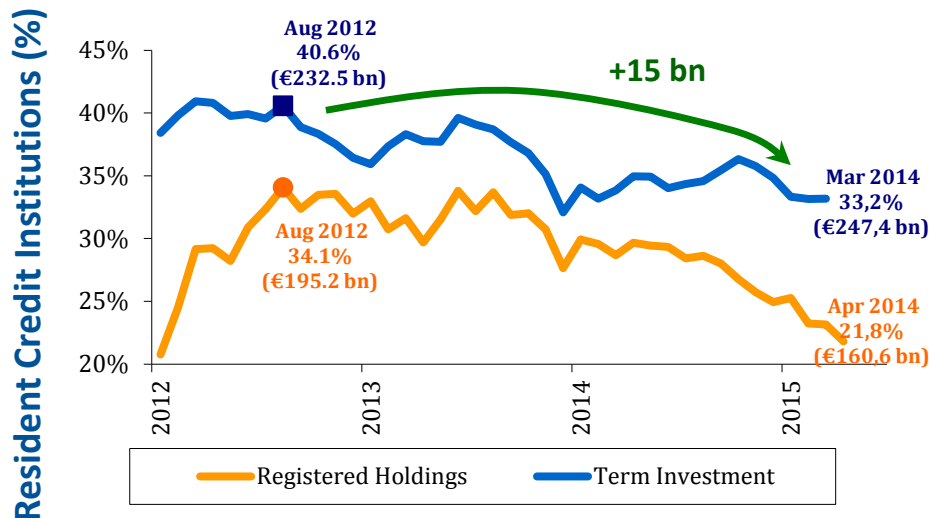
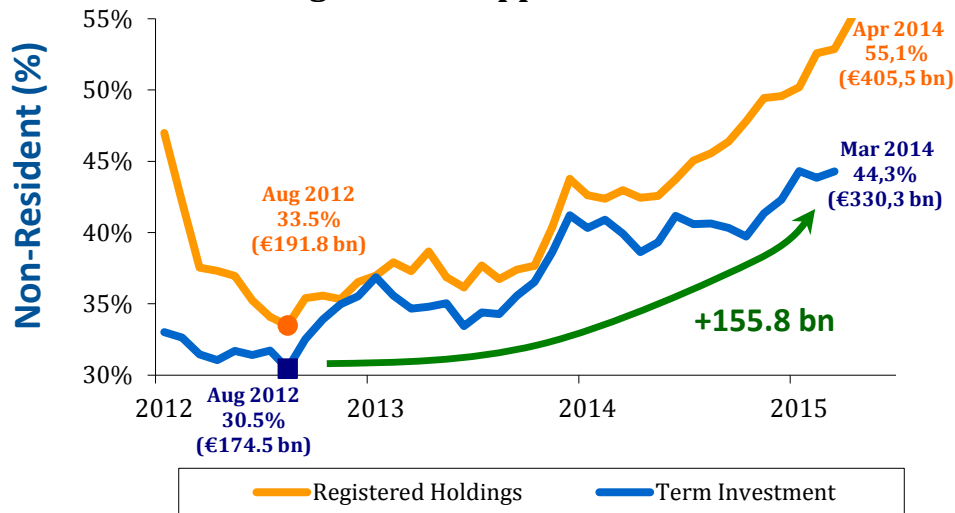
Recent trends in investor base

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



Source: Secretaría General del Tesoro y Política Financiera.
* 2015: Year-on-year change. April 2014 to March 2015

Holdings of Unstripped Government Debt

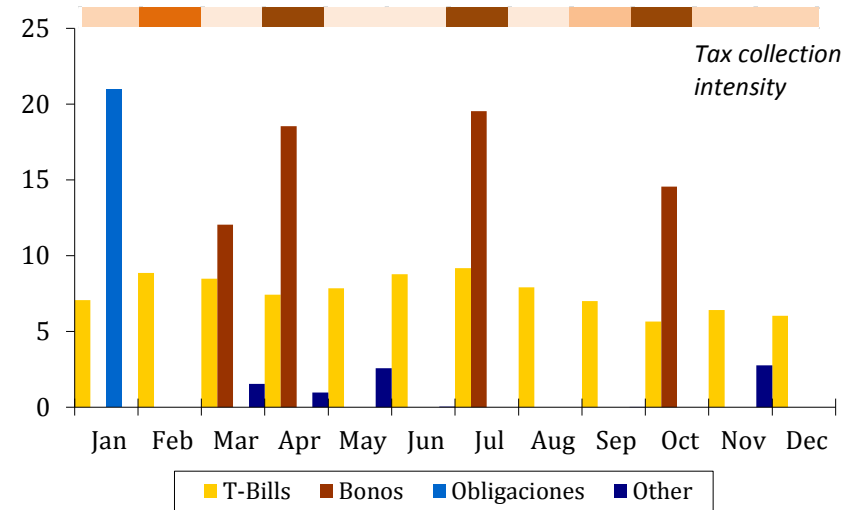


[Link to Data](#)

Prudent debt management

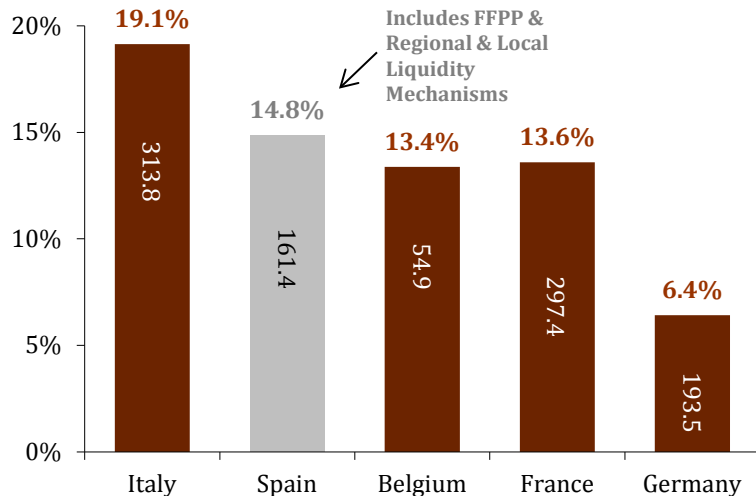
- ▶ Redemption dates of medium- and long-term bonds (mainly January, April, July and October) are accommodated to match the dates of biggest inflows of tax revenues
- ▶ Excess liquidity is lent in the money market each month through weekly, bi-monthly and monthly repo auctions

Monthly Maturity Structure in 2015
as of May 31st 2015
(€ bn)



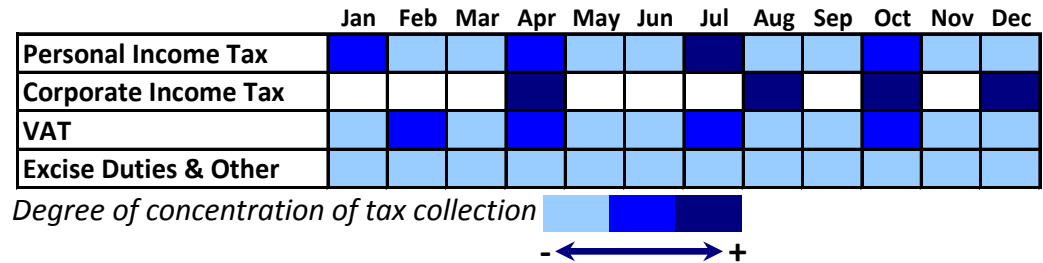
Source: Secretaría General del Tesoro y Política Financiera. [Link to Data](#)

Relative Redemptions of Central Governments
(% of estimated 2015 GDP. June 2015 to May 2016)



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

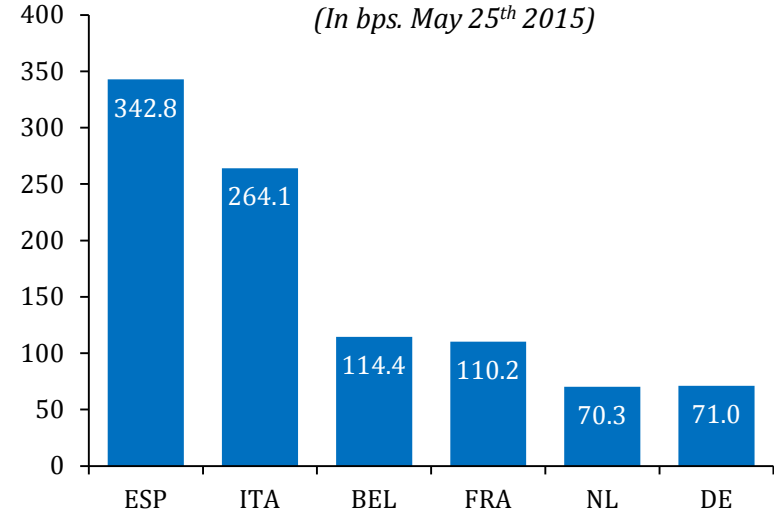
Administrative Distribution of Tax Collection



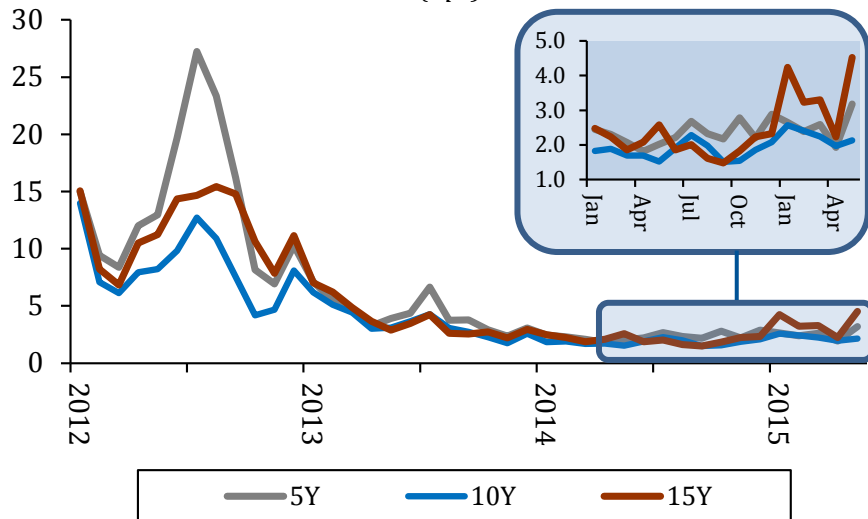
A more liquid debt market despite spread tightening

- ▶ Significant tightening in sovereign spreads
- ▶ Rates have stabilised for longer periods, enabling more efficient investment decisions by market agents, rendering liquidity in secondary markets a key factor

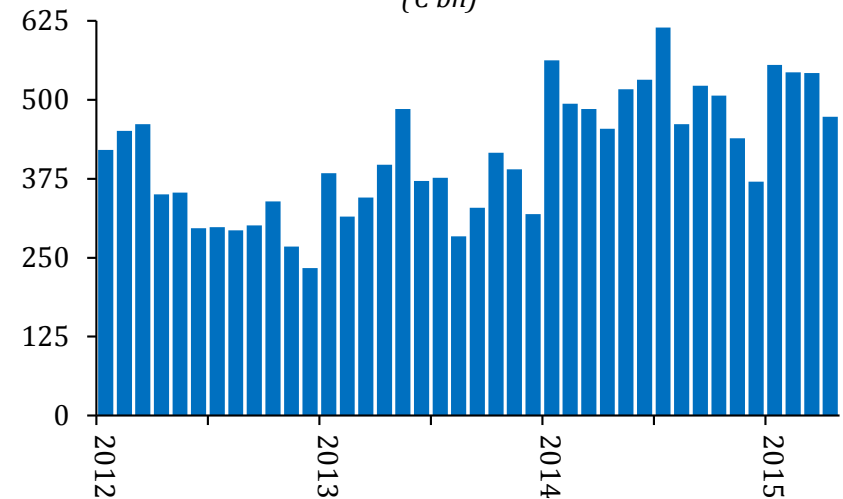
Reduction in Yield Level of 10 Year Government Bonds Since 2013 of Selected Countries
(In bps. May 25th 2015)



Bid-Ask Spreads of Government Bonds
(bps)



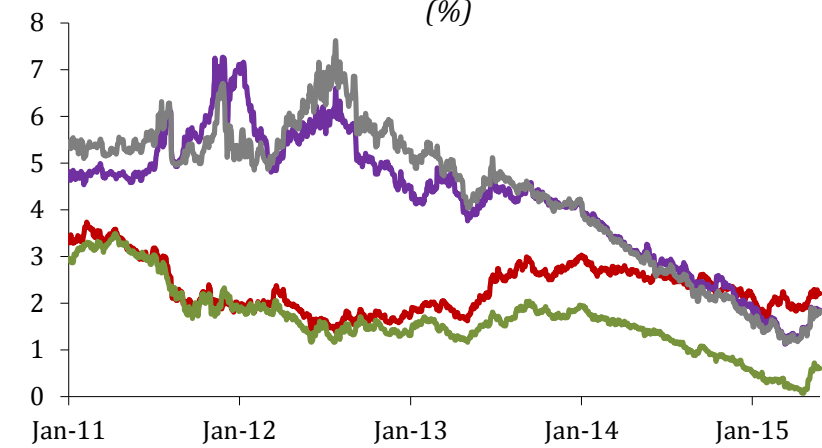
Turnover of Bonos and Obligaciones
(€ bn)



Interest rate volatility has diminished

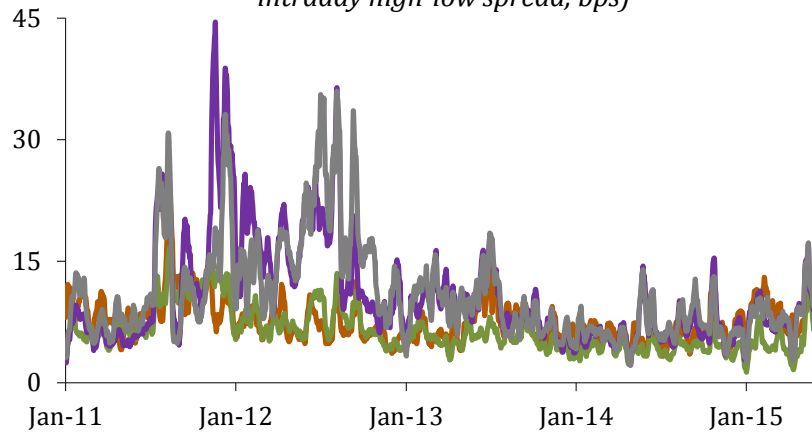
- ▶ Significant tightening in sovereign spreads
- ▶ Rates have stabilised for longer periods, enabling more efficient investment decisions by market agents

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



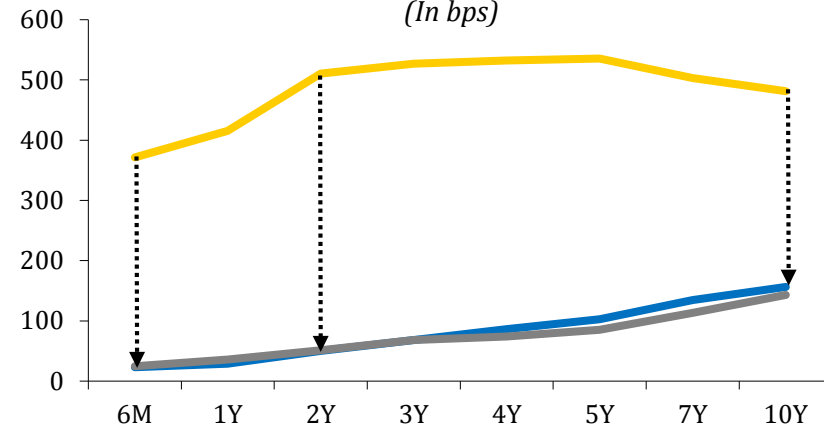
Intraday Yield Range, 10-Day Rolling Average

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



Spain CDS Curves (In bps)

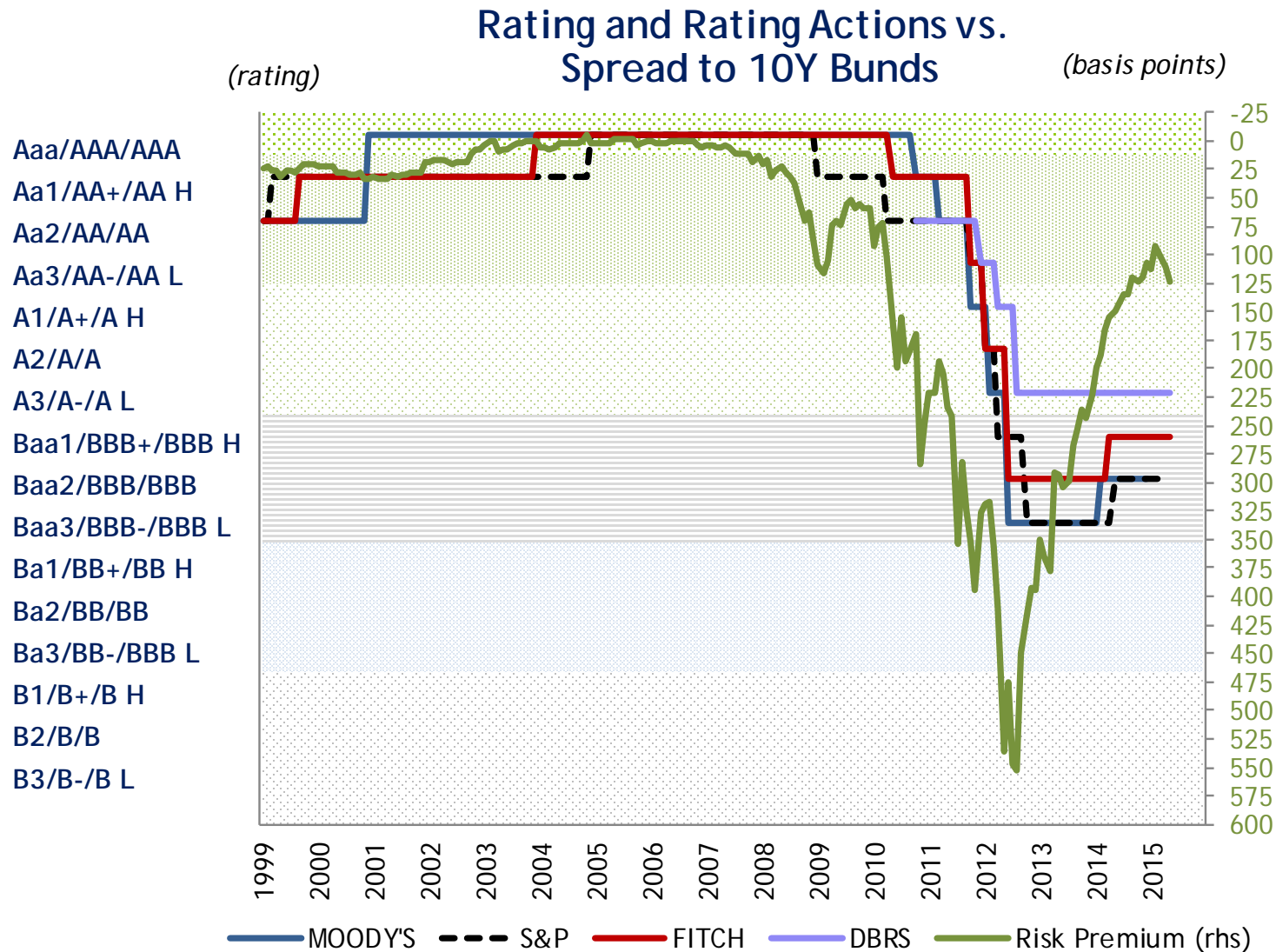
(In bps)



Source: Bloomberg.

[Link to Data](#)

Evolution of Ratings



[Link to Data](#)

More and updated information on the Spanish economy



For spreadsheets click on 'Data'

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Thank you for your attention

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