

Recent Developments in the Spanish Economy & Funding Outlook

January 15th, 2019

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Highlights

- ▶ The Spanish economy will maintain robust growth path with GDP growth forecast of 2.6% in 2018 and 2,2% in 2019
- ▶ National deleveraging is progressing, enabled by sustained combination of growth and a current account surplus
- ▶ Draft Budget Law for 2019 presented to Parliament on 14 January 2019
 - ❑ Reinforces Spain's commitment with the Stability and Growth Pact. Strong pro-European sentiment throughout the crisis
 - ❑ Strong deficit reduction: Targets 2019 deficit of 1.3% of GDP, down from 2.8% in 2018 and below 1.8% envisaged in DBP adopted last October
 - ❑ Strong debt reduction: Targets Debt-to-GDP ratio of 95.4%, down from 98,1% in 2017 and 96.9% in 2018
 - ❑ Impact on growth of additional fiscal adjustment will be marginal
- ▶ Economic policy agenda to pursue structural reforms to address inequality, increase productivity and external competitiveness
- ▶ Recent rating upgrades allow for a widening and deepening of Spain's investor base, and for an improvement in the average quality of participants

Macroeconomic scenario 2018-2019

Macroeconomic scenario (YoY growth rates in percent)								
	2015	2016	2017	2018	Q1	Q2	Q3	2019
Private consumption expenditure	3.0	2.9	2.5	2.3	3.1	2.2	2.1	1.7
General Government consumption expenditure	2.0	1.0	1.9	1.9	2.2	1.9	2.1	1.4
Gross Fixed Capital Formation	6.7	2.9	4.8	5.7	3.8	7.0	5.5	4.4
National Demand (Contribution to GDP Growth)	3.9	2.4	2.9	2.9	3.1	3.1	2.8	2.2
Exports of goods and services	4.2	5.2	5.2	2.4	3.3	2.3	1.3	2.8
Imports of goods and services	5.4	2.9	5.6	3.5	4.4	4.6	2.5	3.1
External demand (Contribution to GDP Growth)	-0.3	0.8	0.1	-0.3	-0.2	-0.6	-0.4	-0.1
Gross Domestic Product	3.6	3.2	3.0	2.6	2.8	2.5	2.4	2.2

Other variables								
	2015	2016	2017	2018	Q1	Q2	Q3	2019
Unemployment rate (in % of Active Population)	22.1	19.6	17.2	15.5	16.7	15.3	14.6	14.0
Full-time Equiv. Employment (YoY Growth)	3.3	3.0	2.9	2.5	2.6	2.5	2.5	1.8
Net lending(+)/borrowing(-) with RoW (% of GDP)	1.7	2.4	2.2	1.3	2.1	1.8	1.5	1.2
Private Consumption deflator (YoY Growth)	-0.2	0.0	1.6	1.6	1.0	1.5	2.0	1.1
Headline Balance General Gov't (in % of GDP)*	-5.3	-4.5	-3.1	-2.7	-2.94	-2.67	-2.66	-1.3
USD/€ exchange rate	1.1	1.1	1.1	1.18	1.23	1.19	1.16	1.15
Euro Area GDP growth (YoY growth)	2.0	1.9	2.5	2.1	2.4	2.2	1.6	1.9
Oil prices (Brent, USD/barrel)	52.2	43.3	54.3	71.3	66.8	74.5	75.1	65.0

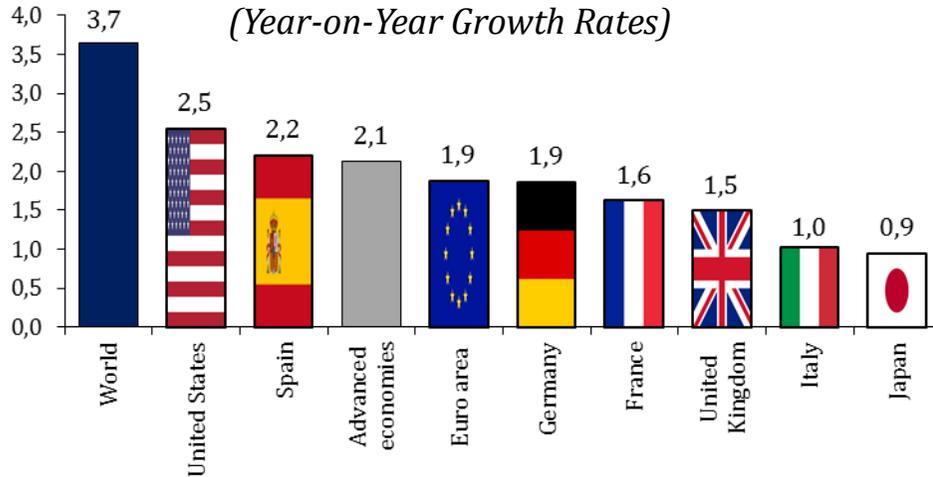
* Including Financial Sector One-Offs

Sources: Ministerio de Economía y Empresa and Ministerio de Hacienda.

Shaded areas are realisations. In white, forecasts contained in the 2019 Draft Budget

Economic sentiment

IMF Growth Forecasts for 2019
(Year-on-Year Growth Rates)



Source: IMF. WEO October 2018.

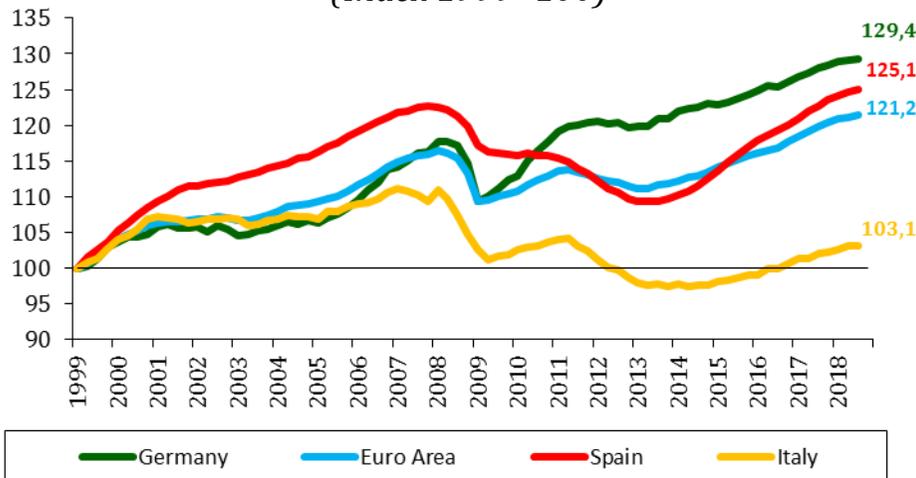
Growth Forecasts for 2019
(Year-on-Year Growth Rates)

Institution	2018	2019
IMF	2.5	2.2
OECD	2.6	2.2
European Commission	2.6	2.2
Bank of Spain	2.5	2.2
FUNCAS consensus	2.6	2.2
CEOE*	2.6	2.3
BBVA**	2.6	2.4
Consensus Forecast®	2.6	2.2
Government	2.6	2.2

* 2.3% growth for 2019 also forecasted by Citigroup, Goldman Sachs, AFI, CEPREDE, Econ Intelligence Unit, Bankia, CEOE or Cemex.

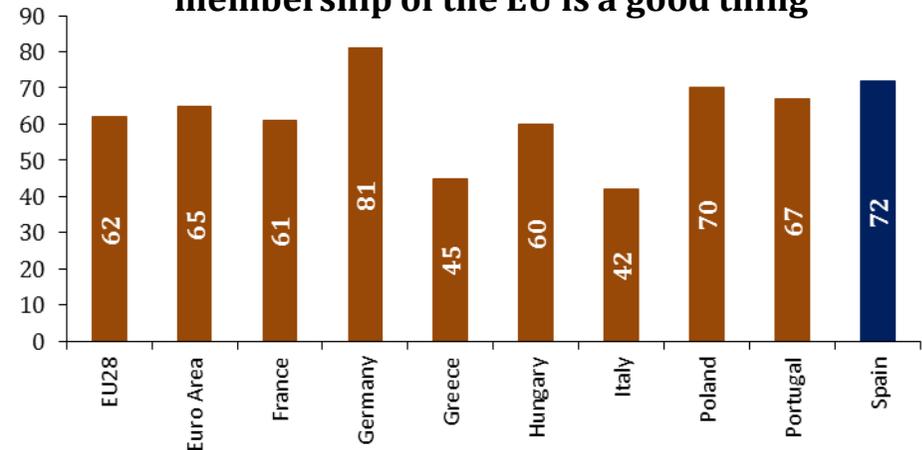
** 2.4% growth for 2019 forecasted by Oxford Economics, HSBC, Axesor or BBVA.

Per capita GDP Volume
(Index 1999=100)



Source: EUROSTAT.

% of population that thinks that membership of the EU is a good thing

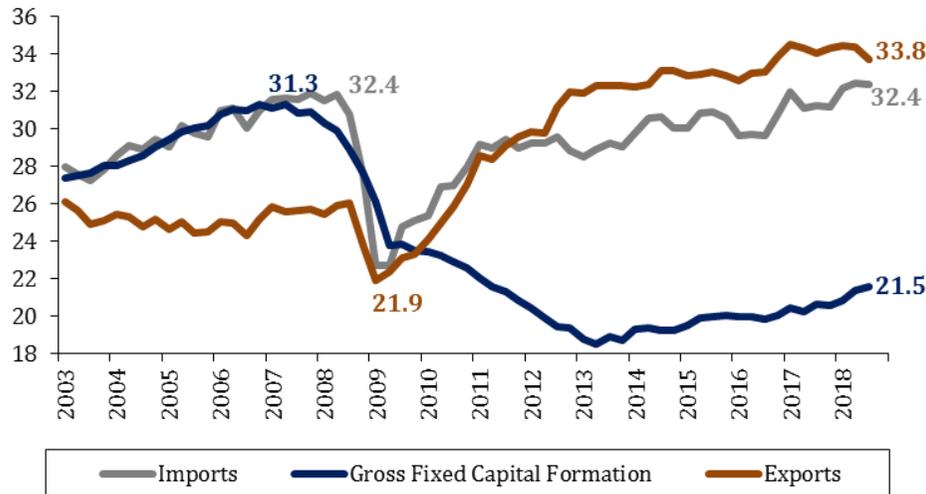


Source: EUROSTAT.

Spain's growth pattern

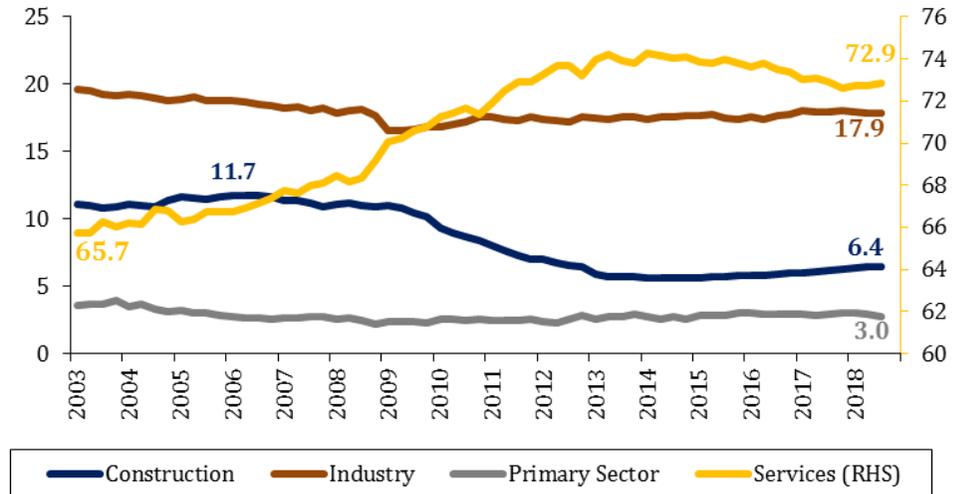
- ▶ Current account surplus and net lending capacity vis a vis rest of the world
- ▶ Subdued inflation and strong job creation
- ▶ Rebalancing of weight of construction sector and higher weight of services sector
- ▶ Strong investment growth converging to Euro Area average

Exports and Imports of Goods and Services & Gross Fixed Capital Formation
(% of GDP)



Source: Instituto Nacional de Estadística.

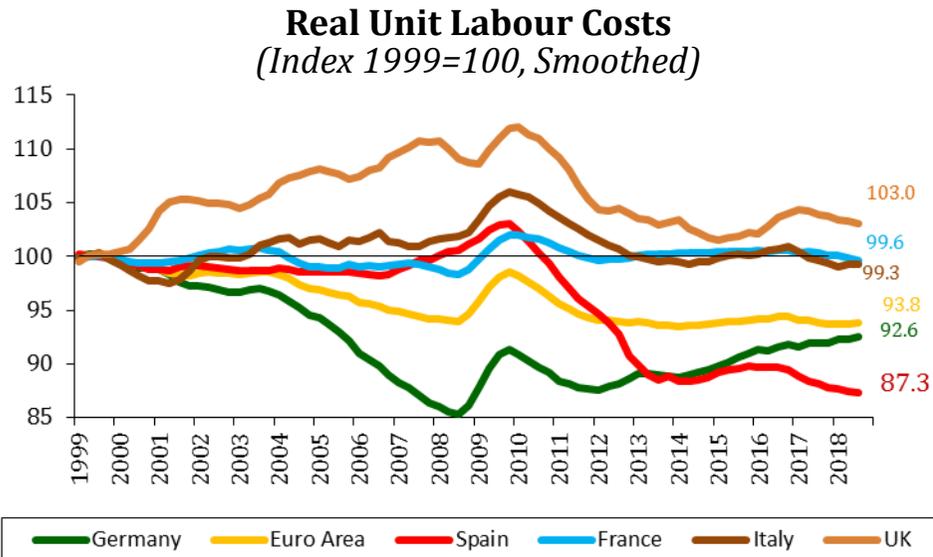
Gross Value Added
(% of GDP)



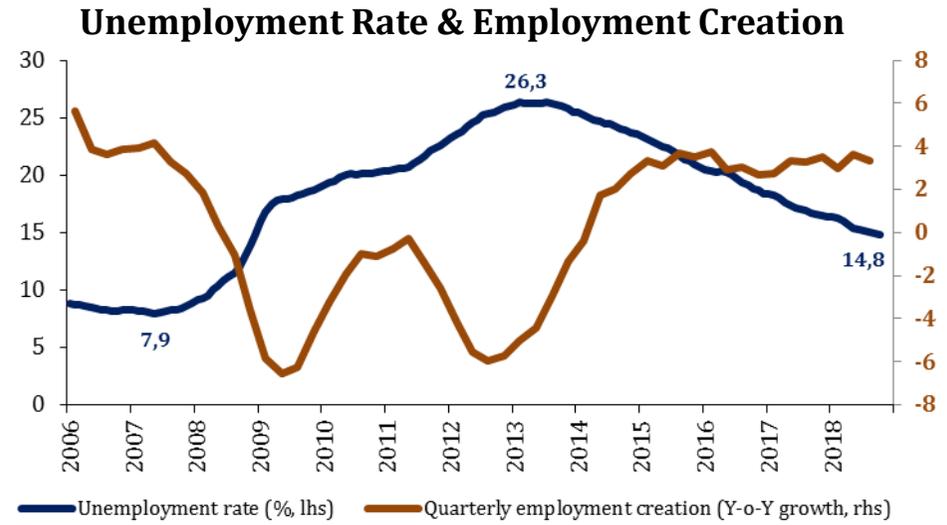
Source: Instituto Nacional de Estadística.

A recovery intensive in labour creation

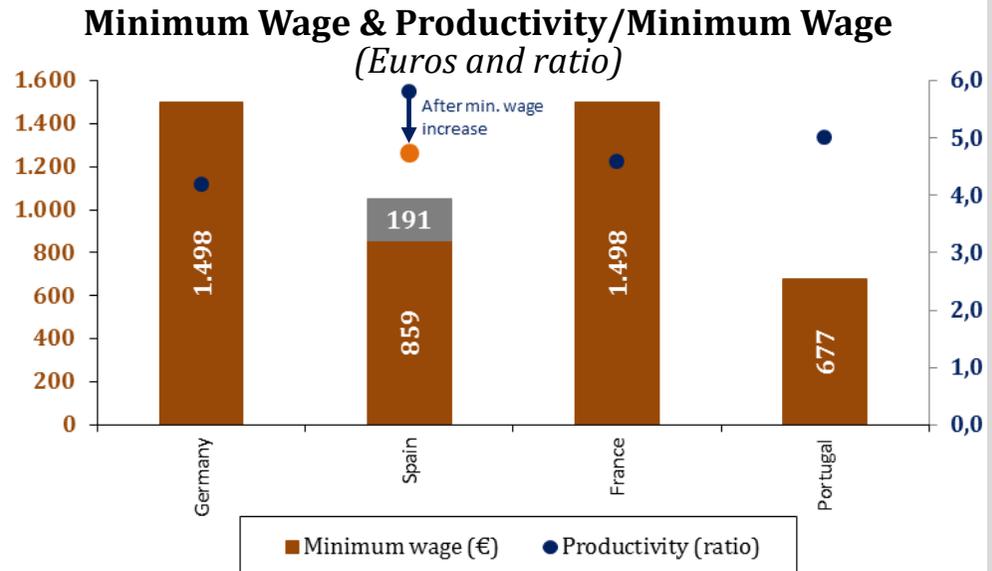
- ▶ 2.5 million jobs created since 2014, equivalent to over 25% of the total employment generated in the Euro Area
- ▶ Falling unemployment fuels internal demand
- ▶ Increased real labour productivity has led to enhanced competitiveness
- ▶ Measures to increase job quality in order to fight inequality, foster stability & human capital



Source: EUROSTAT.



Source: EUROSTAT, Ministerio de Economía y Empresa.

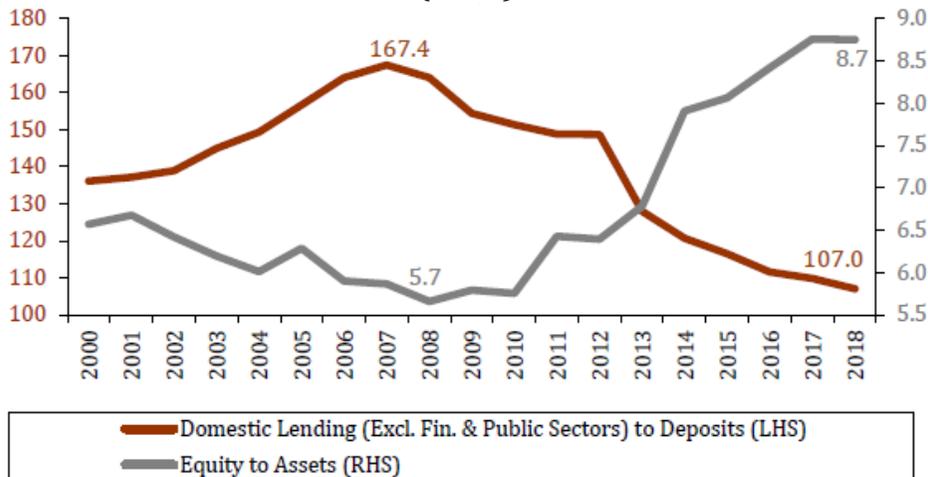


Source: EUROSTAT.

Banking sector adjustment

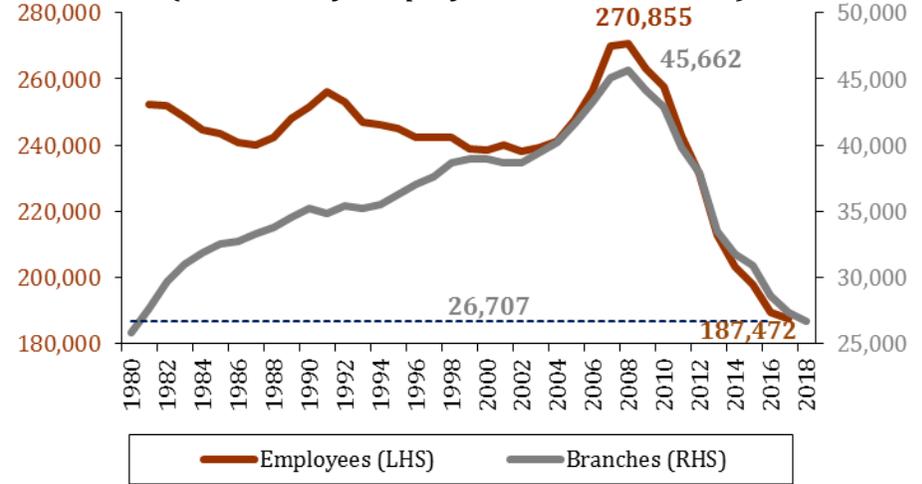
- ▶ Adjustment of the banking sector:
 - ☐ Downsizing & loss recognition
 - ☐ Enhanced capitalisation and profitability
- ▶ Strong improvement in NPLs: harmonised NPL ratio below Euro Area average
- ▶ EBA-2018 stress tests reveal reduced average impact under adverse scenario for Spanish banks

Loan-to-Deposits & Equity to Assets
(In %)



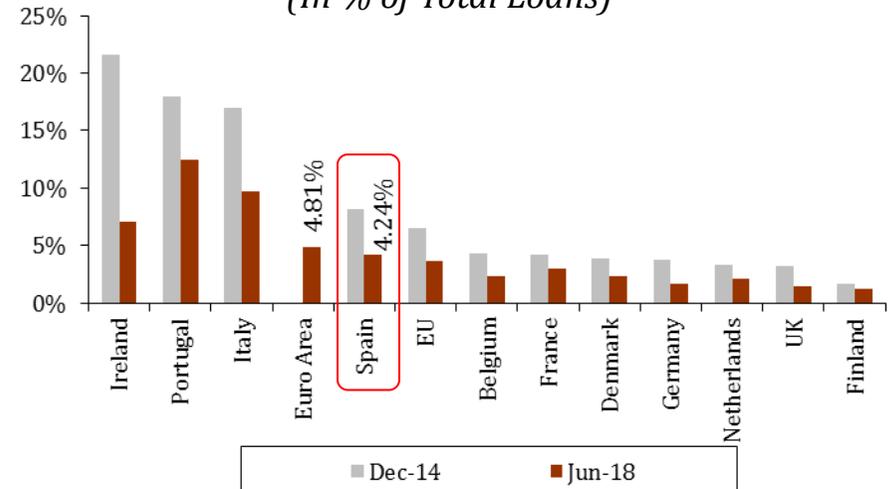
Source: Bank of Spain.

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



Source: Bank of Spain.

Harmonised NPL Ratio
(In % of Total Loans)

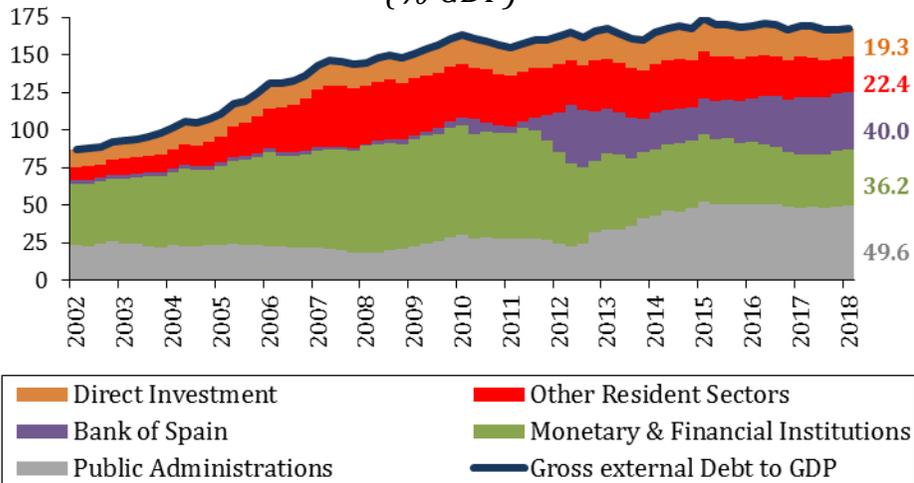


Source: EBA. Risk Dashboard Interactive Tool.

Private deleveraging

► Since 2010Q2, private sector debt decreased by 62.1pp of GDP → households & nonfinancial corporations' leverage below Euro Area average

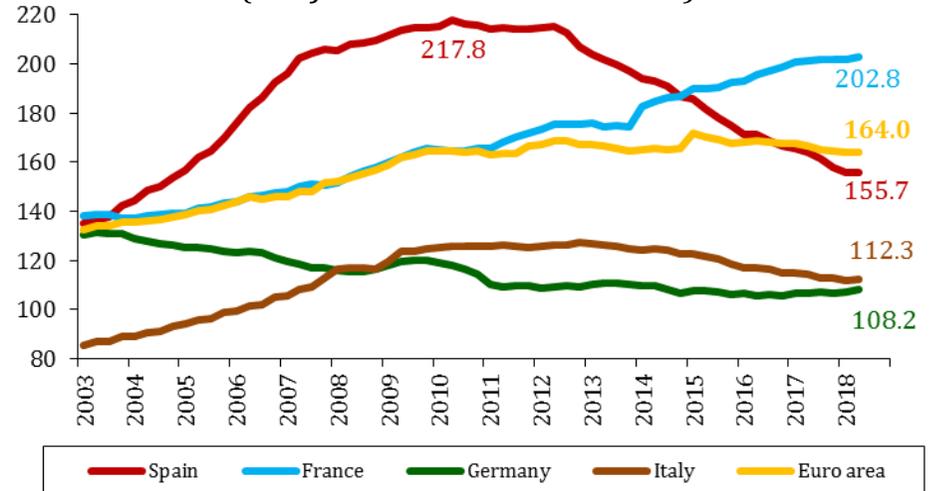
Gross External Debt. By Debtor Sub-Sector.
(% GDP)



Source: Bank of Spain.

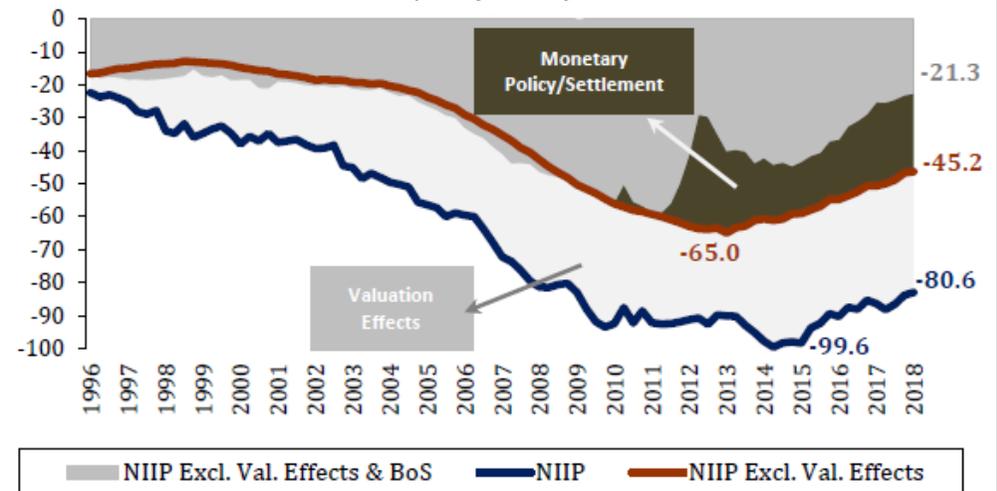
NOTE: The gross external debt position equals total IIP liabilities excluding all equity (equity shares and other equity) and investment fund shares and financial derivatives and employee stock options.

Private Sector Debt Dynamics
(% of GDP. Non-Consolidated)



Sources: EUROSTAT, Banco de España and Instituto Nacional de Estadística.

Net International Investment Position
(% of GDP)

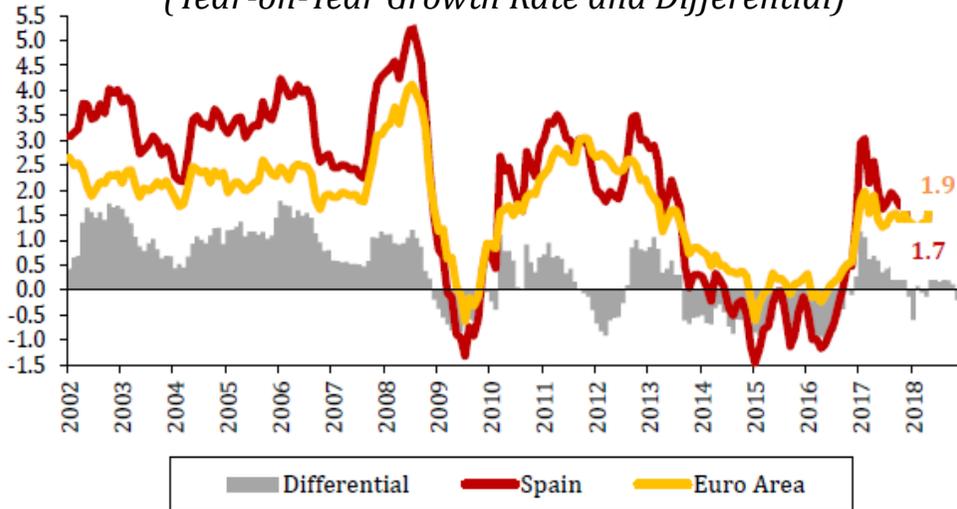


Source: Bank of Spain and own calculations.

Inflation broadly in line with Euro Area average

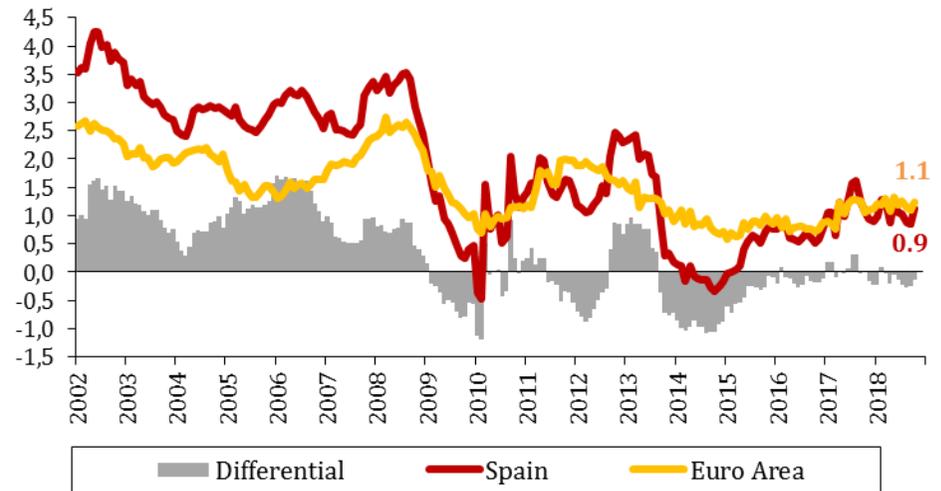
- ▶ Core inflation remains well below ECB objective
- ▶ Energy remains a major contributor to shifts in headline inflation

Harmonised Inflation of Consumer Prices
(Year-on-Year Growth Rate and Differential)



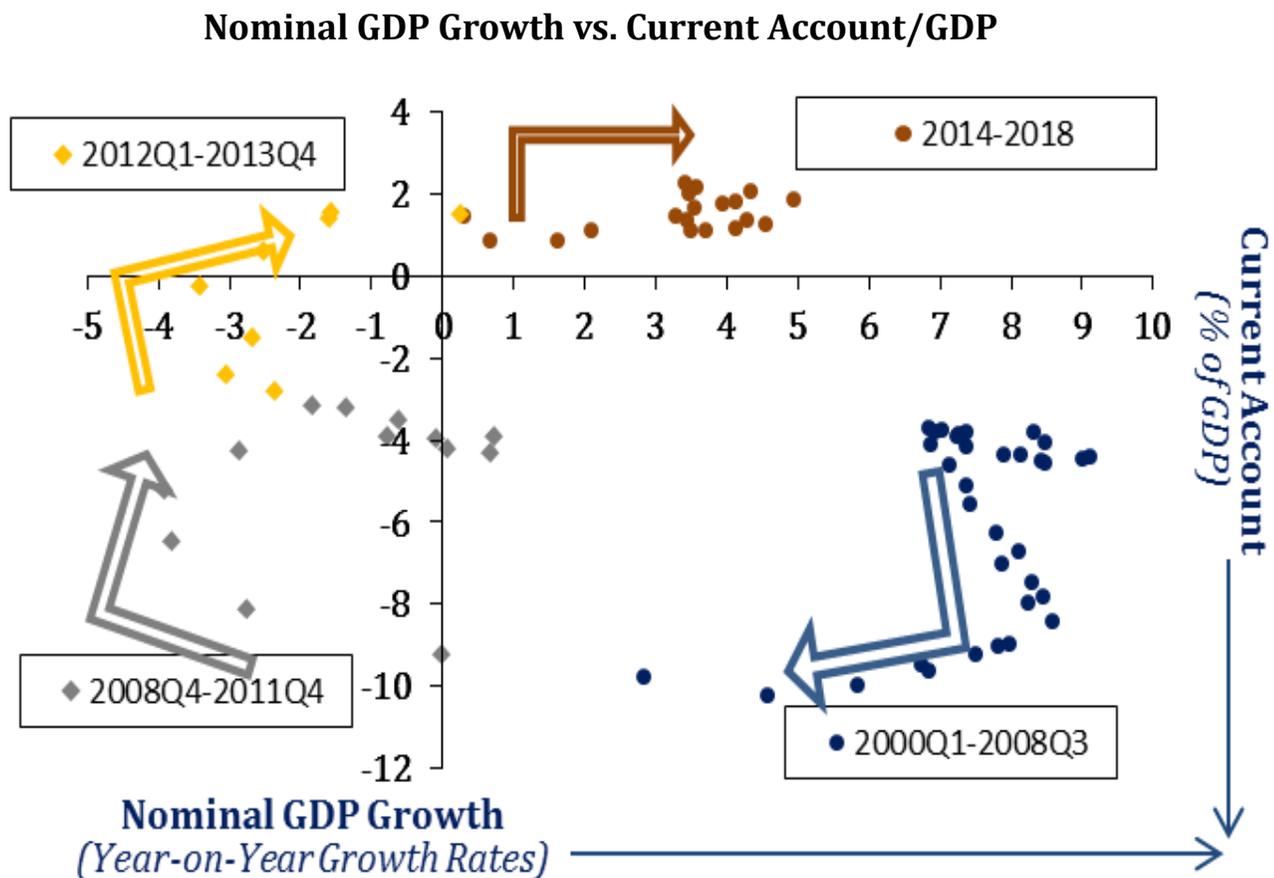
Source: EUROSTAT.

Core Inflation
(Year-on-Year Growth Rate and Differential)



Source: EUROSTAT.

Result: persistent growth with current account surplus



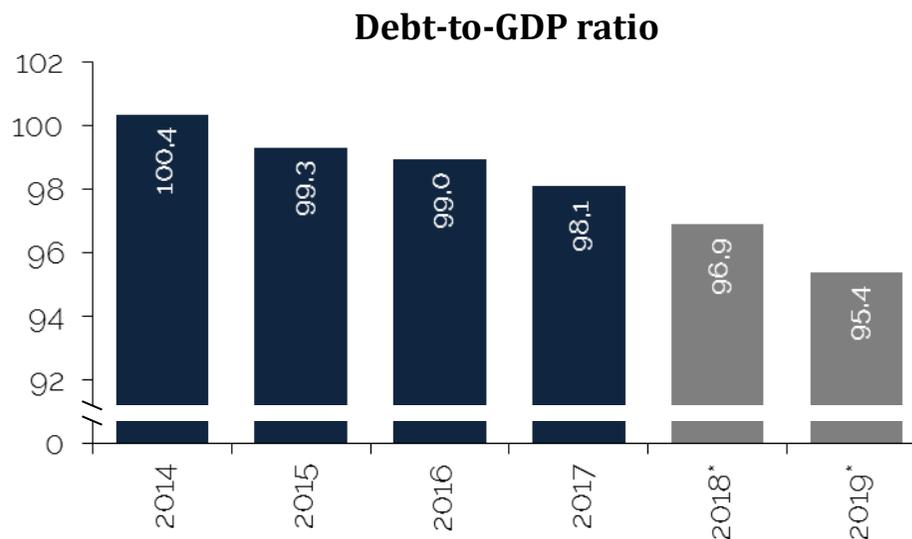
Source: Instituto Nacional de Estadística and Bank of Spain.

Fiscal policy framework

Net Lending(+)/Borrowing. (% of GDP)											
	2011	2012	2013	2014	2015	2016	2017	Forecast			
								2018	2019	2020	2021
Central Government	-3,6	-7,9	-4,8	-3,7	-2,8	-2,6	-1,89	-1,5	-0,3	0,0	0,0
Autonomous Regions	-5,1	-1,9	-1,6	-1,8	-1,7	-0,9	-0,36	-0,3	-0,1	0,0	0,0
Local Governments	-0,8	0,3	0,6	0,5	0,4	0,6	0,61	0,6	0,0	0,0	0,0
Social Security	-0,1	-1,0	-1,1	-1,0	-1,2	-1,6	-1,44	-1,5	-0,9	-0,5	-0,4
General Government	-9,64	-10,47	-6,99	-5,97	-5,27	-4,47	-3,08	-2,7	-1,3	-0,5	-0,4

Source: Ministerio de Hacienda.

Forecasts are those contained in the Draft Budget for 2019 presented in January.

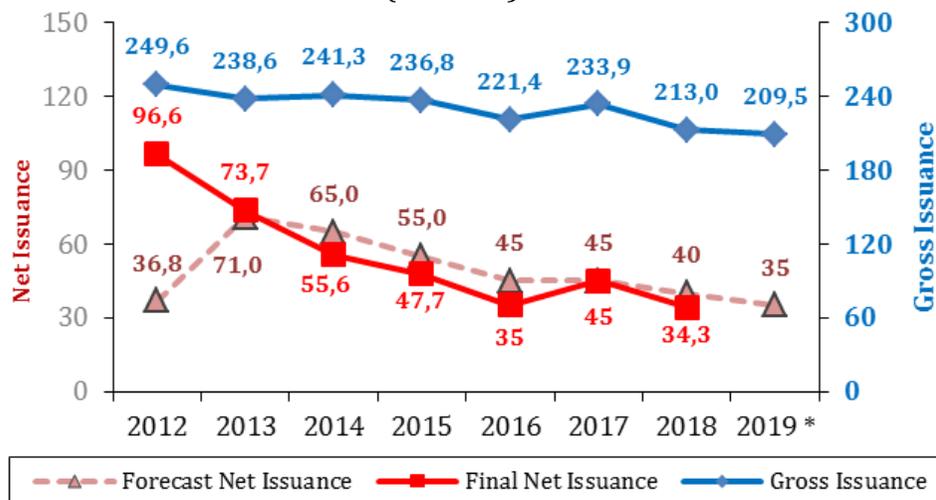


Source: Secretaría General del Tesoro y Financiación Internacional.

The Treasury's funding programme in 2019

- ▶ The Government's commitment to fiscal consolidation will allow the Treasury to continue to reduce its recourse to the capital markets in 2019
- ▶ Net issuance forecasted at €35 bn in 2019; to be attained exclusively through the issuance of medium and long-term instruments
- ▶ Expected gross medium and long-term issuance of 126.9 billion euros, 3.8% less than in 2018

The Treasury's Funding Programmes since 2012
(In € bn)



Source: Secretaría General del Tesoro y Financiación Internacional.

Funding Programme in 2019

(In billion euros and in effective terms)	End 2018	Forecast 2019
Total Net Issuance	34,277	35,000
Total Gross Issuance	212,964	209,526
Medium- and Long-term		
Gross Issuance ¹	131,979	126,933
Amortisation ¹	89,310	91,933
Net Issuance ¹	42,669	35,000
Letras del Tesoro		
Gross Issuance	80,984	82,592
Amortisation	89,377	82,592
Net Issuance	-8,393	0,000

¹ Includes Bonos & Obligaciones, debt in other currencies, loans and assumed debts.

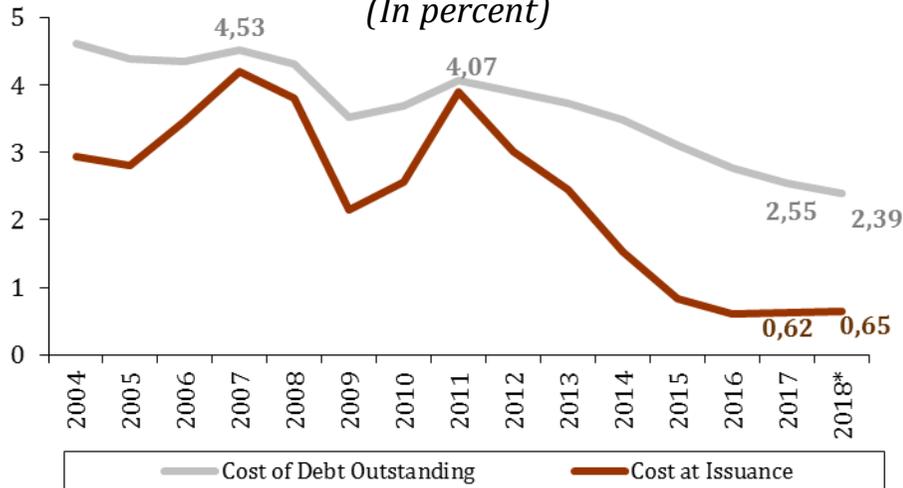
Source: Secretaría General del Tesoro y Financiación Internacional.

Cost and life of debt: a longer portfolio at historically low rates

- ▶ Average cost of debt outstanding at historic low (2.39%)
- ▶ Slight increase in cost of issuance in 2018 due to the issuance of longer tenors
- ▶ Since 2013 average life of debt outstanding has increased from 6.20 to 7.45 years

Cost of Debt Outstanding and Cost at Issuance

(In percent)

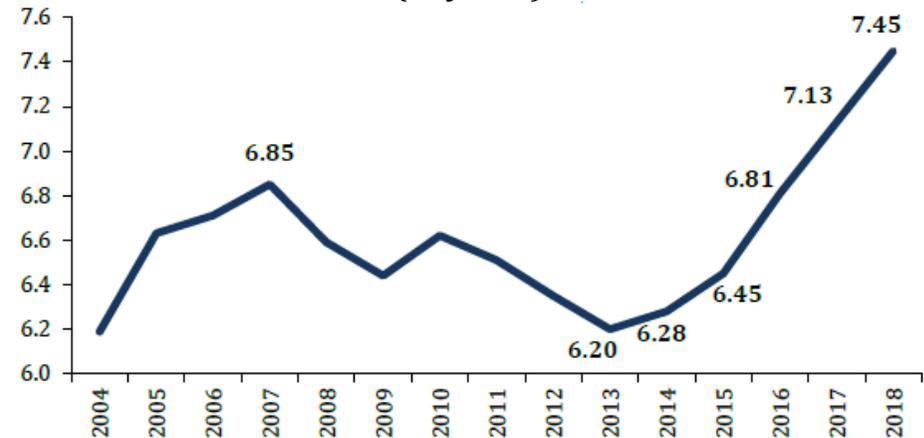


Source: Secretaría General del Tesoro y Financiación Internacional.

*As of 15/01/2019

Average Life of Debt Outstanding

(In years)

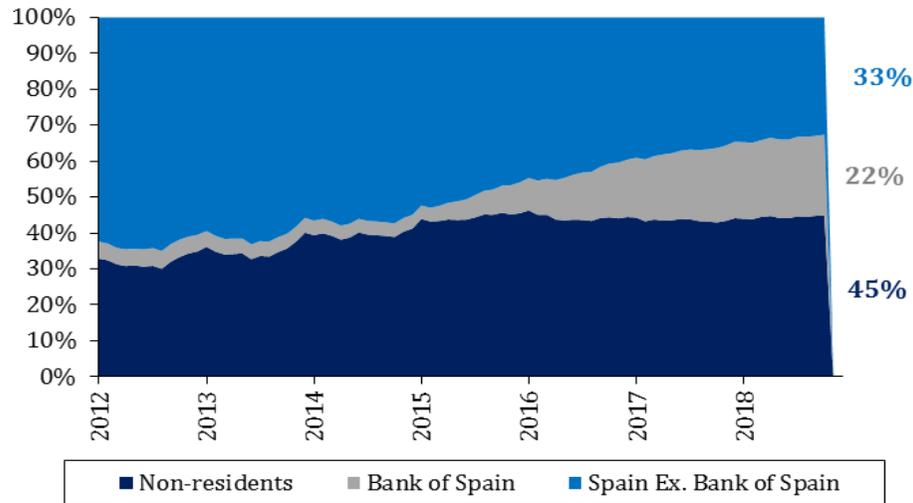


Source: Secretaría General del Tesoro y Financiación Internacional.

Recent trends in investor base

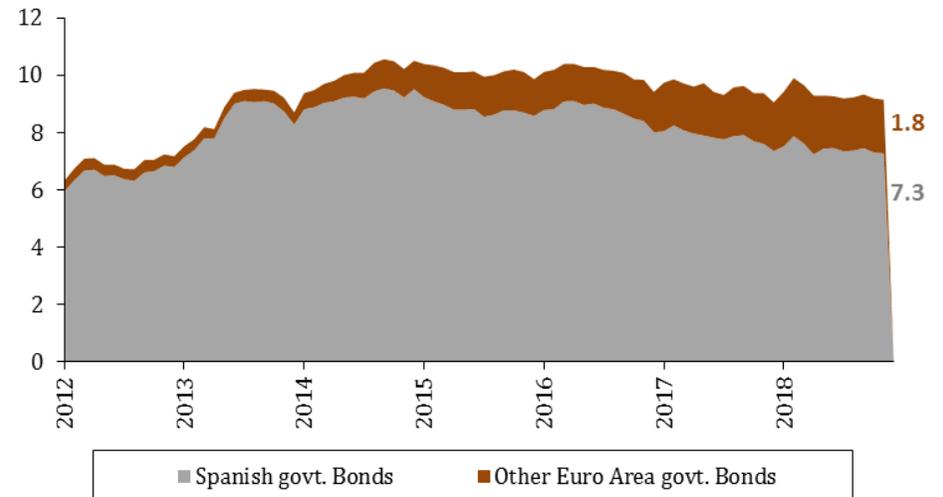
- ▶ Non-residents continue to be the leading investors with a share around 44.8%
- ▶ Spanish banks have been reducing their absolute and relative holdings of Spanish bonds
- ▶ This move has been compensated by the increase in Bank of Spain's holdings to 22.3%

Holdings of Letras & Bonos and Obligaciones del Estado
(% Structure)



Source: Bank of Spain.
(2012-2015 IBERCLEAR data / 2016- Securities Holdings Statistics)

Government bond holdings as % of Spanish bank's balance sheet.

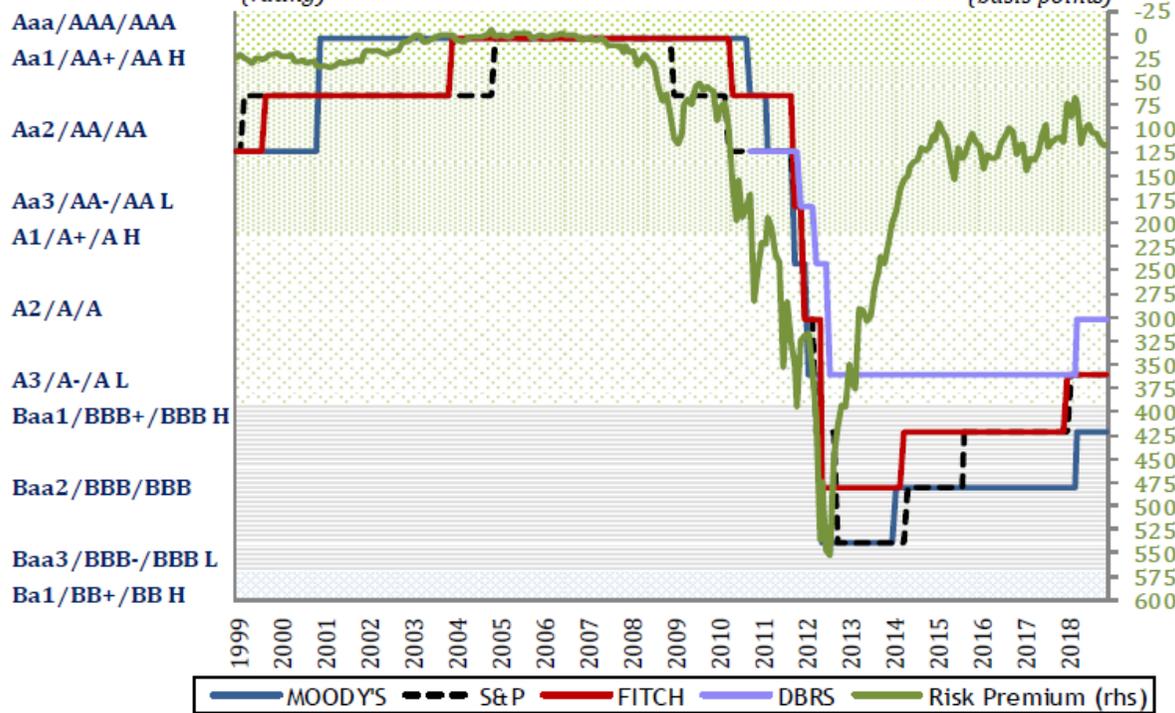


Source: ECB.

Ratings

- ▶ Expecting more foreign investors after recent upgrades: A stable outlook (DBRS), A- positive outlook (S&P), A- stable outlook (Fitch), Baa1 stable (Moody's)

Rating and Rating Actions vs. End-of-Month Spread to 10Y Bunds



Announced Rating Dates in 2019.

	Fitch	S&P	DBRS	Moody's
January	11			
February				
March		22	22	
April				
May				24
June	21			
July				
August				
September		20	20	
October				
November				15
December	13			

Thank you for your attention

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