



# The Kingdom of Spain: Economic Policy & Funding

February 2015

# **1. Transformation of Spain's Growth Model**

## **2. Spanish Economic Policy**

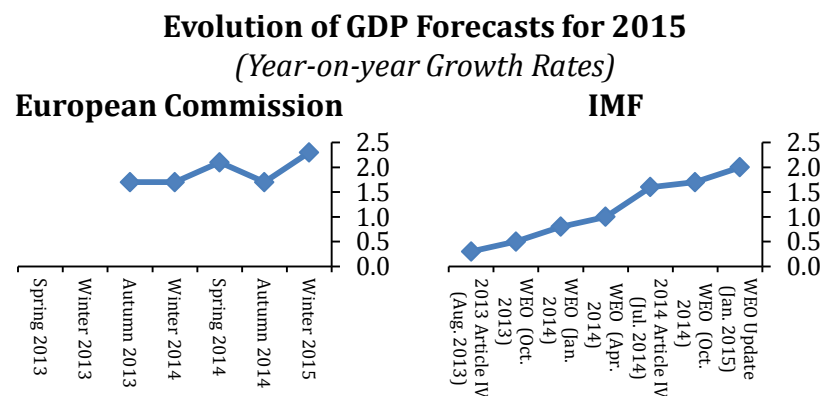
## **3. The Funding Programme of the Spanish Treasury**

# Macroeconomic scenario

- ▶ In 2014Q4 the Spanish economy grew by 0.7% QoQ, confirming its accelerating trend. As a result, in 2014 GDP grew by 1.4%, above the Government's estimate, and at the upper end of analysts' projections
- ▶ Upward revision to 2015 GDP estimates by private and public sector institutions

| Macroeconomic scenario (Year-on-year growth rates in percent) |             |            |            |
|---|-------------|------------|------------|
|   | 2013        | 2014       | 2015(f)    |
| Private consumption   | -2.3        | ..         | 2.1        |
| Government consumption  | -2.9        | ..         | -1.0       |
| Gross Fixed Capital Formation                                 | -3.7        | ..         | 4.4        |
| National Demand*  | -2.7        | ..         | 1.8        |
| Exports of goods and services                                 | 4.3         | ..         | 5.2        |
| Imports of goods and services                                 | -0.5        | ..         | 5.0        |
| External demand*  | 1.4         | ..         | 0.2        |
| <b>Gross Domestic Product</b>                                 | <b>-1.2</b> | <b>1.4</b> | <b>2.0</b> |
| GDP - EC Winter Forecast (Feb. 2015)                          | ..          | 1.4        | 2.3        |
| GDP - IMF WEO Update (Jan. 2015)                              | ..          | 1.4        | 2.0        |
| GDP - OECD (Nov. 2014)  | ..          | 1.3        | 1.7        |
| GDP - FUNCAS Forecast panel (Jan. 2015)                       | ..          | 1.3        | 2.0        |

| Other macroeconomic variables                        |      |      |       |
|--|------|------|-------|
| Unemployment rate (in %)                             | 26.1 | 24.4 | 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 in the General State Budgets |         |         |
|---|---------|---------|
|   | 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   |

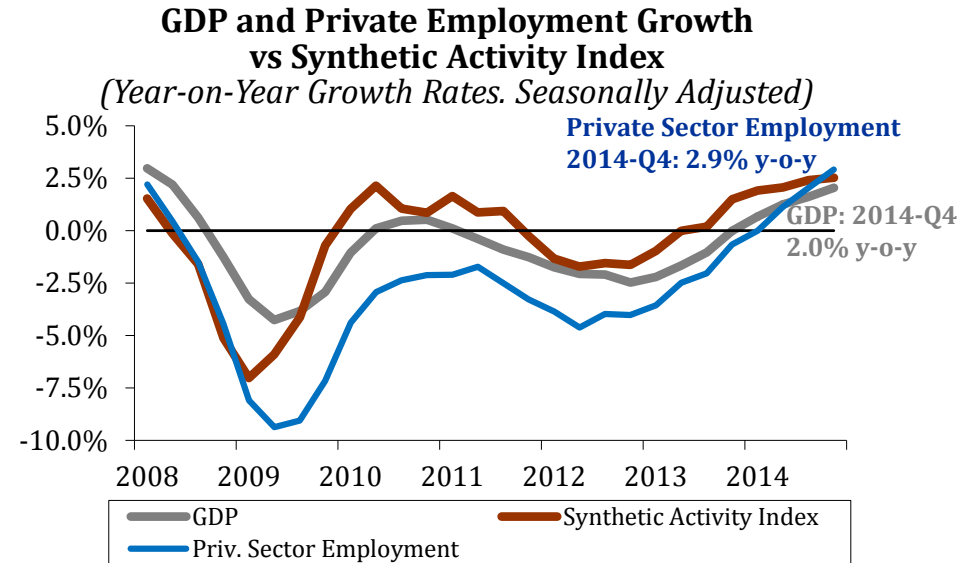
Sources: Ministerio de Economía y Competitividad, OECD, IMF and European Commission.

\* Contributions to GDP in p.p.

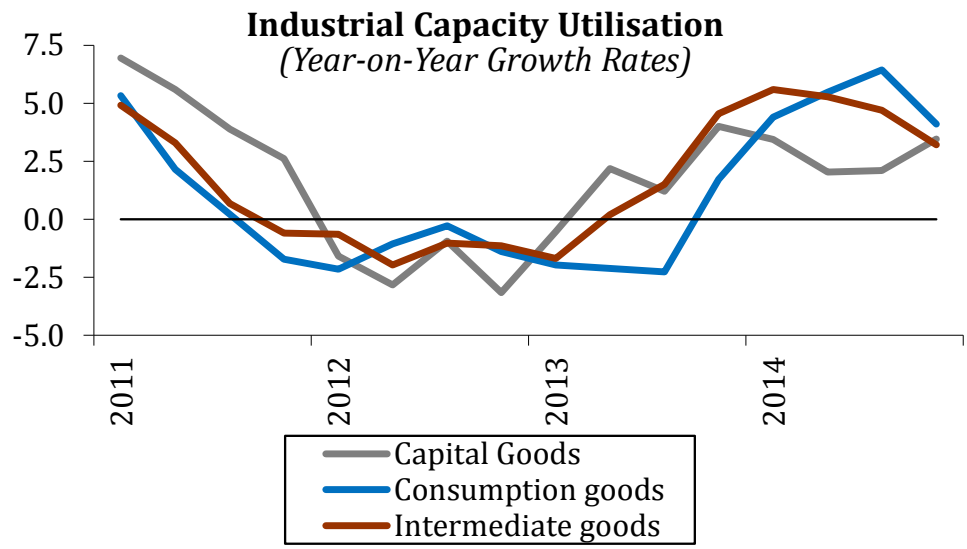
[Data](#)

# Economic recovery led by the private sector

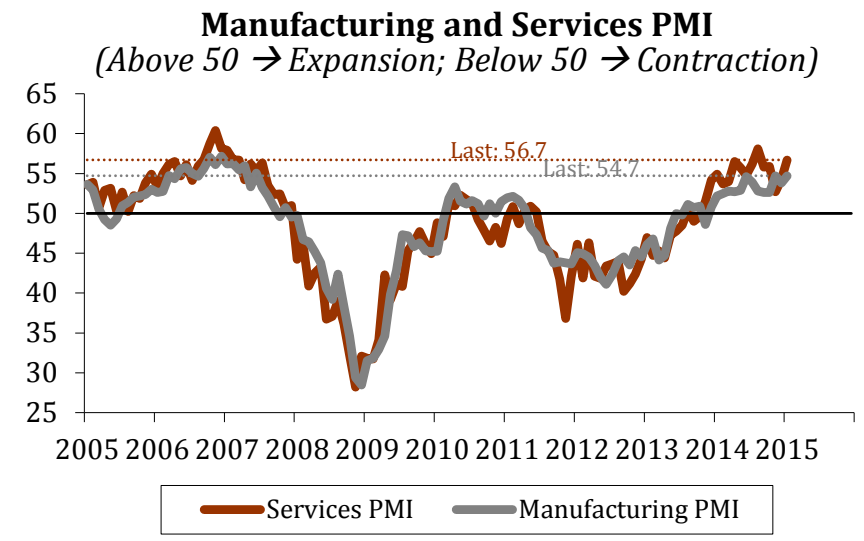
- ▶ Structural reforms already in place allow for a better response to positive demand-shocks
- ▶ Consumer confidence and industrial capacity are recovering strongly after a period of protracted slowdown
- ▶ Improvement in recent employment data reinforces the trend into 2015



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



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

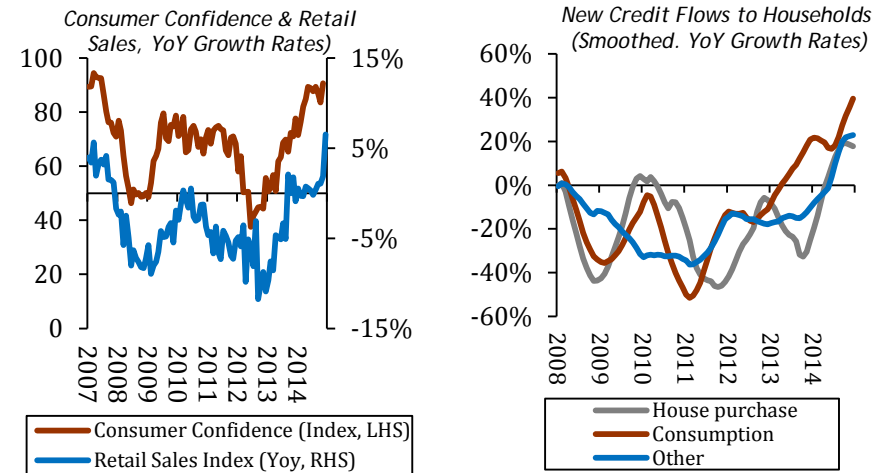


Source: Ministerio de Economía y Competitividad. [Data](#)

# New credit flows are gathering steam

- ▶ SME funding and new credit to households continued to improve. Loans for up to €1 million are growing by more than 10% year-on-year
- ▶ Lending rates for up to €1 million have fallen significantly in 2014 and are now much closer to core country levels
- ▶ Household loans for home and consumption purchases are growing since mid-2014

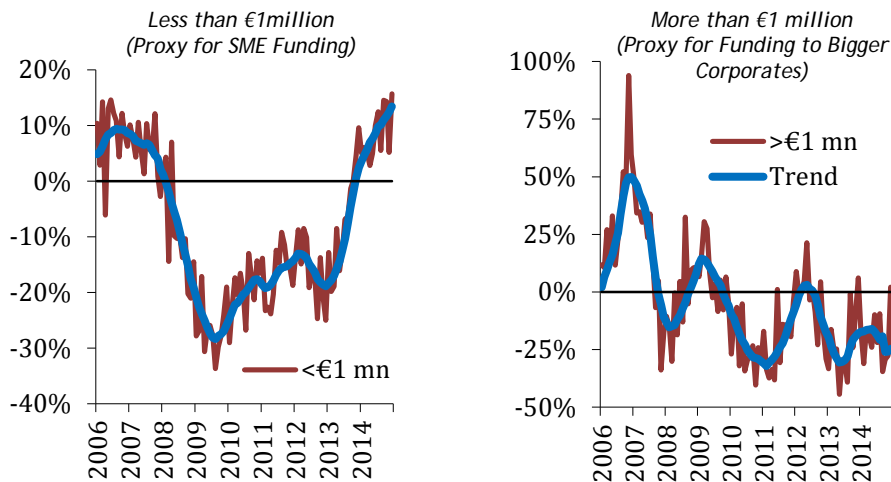
## New Credit Flows to Households & Consumer Confidence (Smoothed. Year-on-Year Growth Rates)



Source: Ministerio de Economía y Competitividad.

[Data](#)

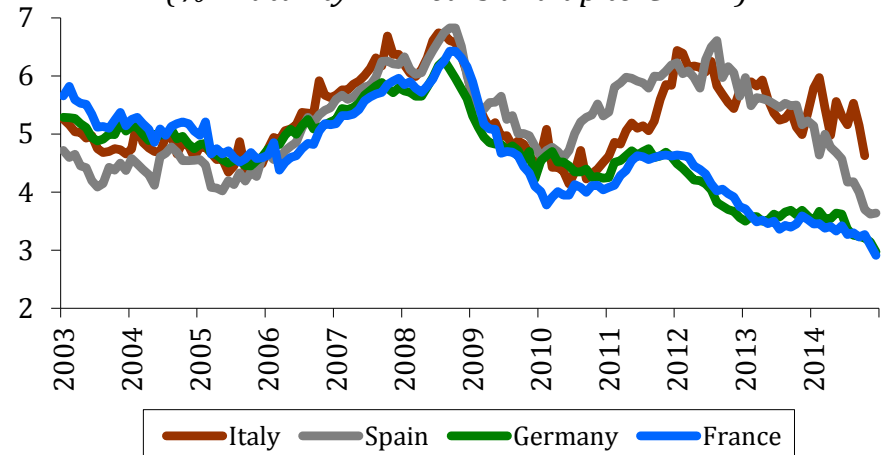
## New Credit to Non-Financial Firms by Size of Loan (Smoothed. Year-on-Year Growth Rates)



Source: Ministerio de Economía y Competitividad.

[Data](#)

## Lending Rates of New Loans to Non-Financial Corporations (%. Maturity 1-5 Years and up to €1 mn)



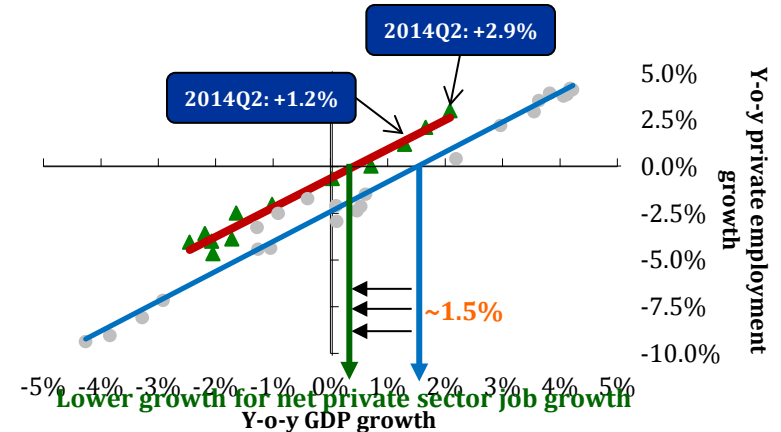
Source: ECB.

[Data](#)

# Structural transformation of labour dynamics

- ▶ Since 2011 the number of employees in the public sector has diminished substantially, reaching 2007 levels: a reduction by 379,000 employees since 2011-Q3
- ▶ New regulatory framework has reduced the minimum GDP growth needed for net private sector job creation, while maintaining productivity growth
- ▶ The lag between GDP growth and employment creation has diminished to one quarter
- ▶ The 2014 reform of the Activation Policies with special incidence on productivity, youth and structural unemployment

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

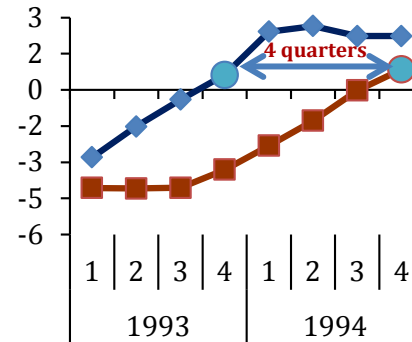


Source: National Statistics Institute.

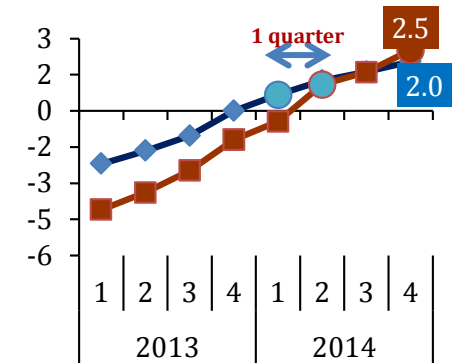
[Data](#)

**Lag Between GDP Growth & Employment**

1993-1994



2013-2014



Source: National Statistics Institute.

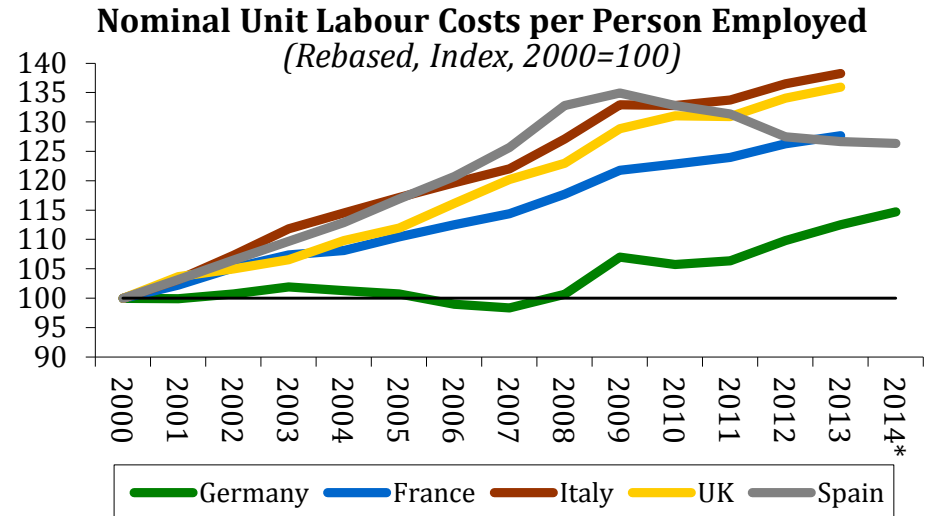
[Data](#)

# Wage moderation, rebalancing and competitiveness

- ▶ The initial productivity shock in 2008-2009 caused by soaring unemployment
- ▶ The structural reforms since 2011 have had a positive impact on unit labour costs and productivity:

☐ Nominal unit labour costs have declined by 6.9% since the peak in 2009 and are at similar levels to those in 2007-Q2

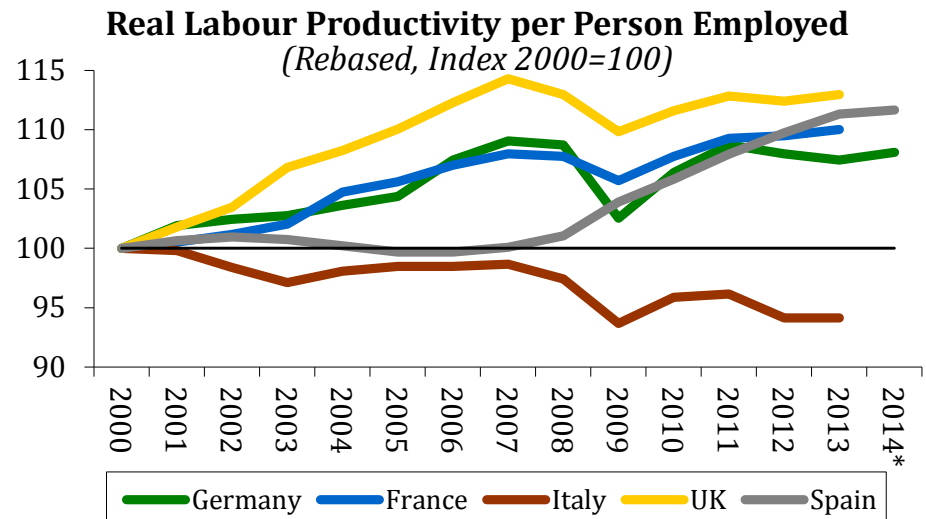
☐ Real labour productivity has steadily increased since 2008 due to the shift from non tradable goods towards tradable goods and services, erasing relative productivity losses registered up to 2008



Source: Eurostat.

[Data](#)

Spain: up to 2014-Q3



Source: Eurostat.

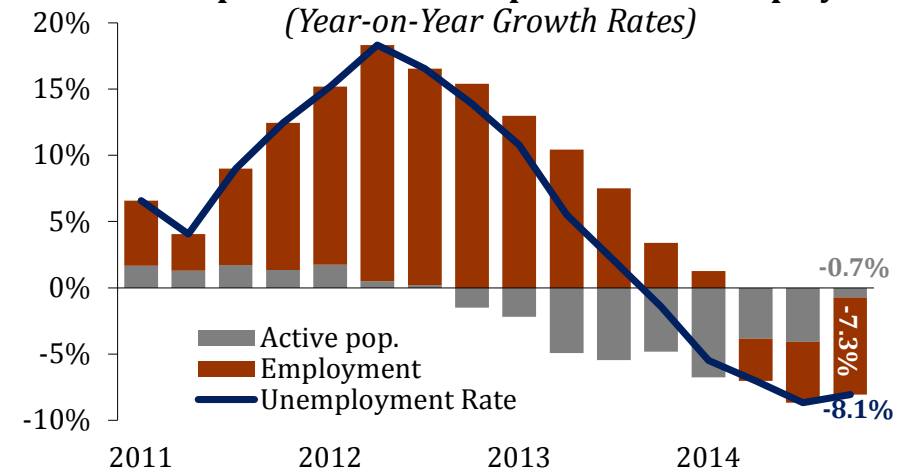
[Data](#)

Spain: up to 2014-Q3

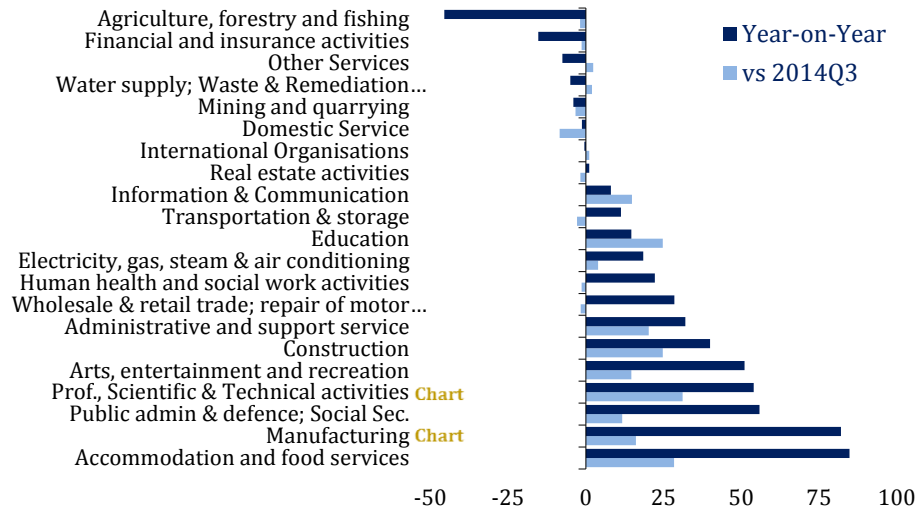
# The unemployment rate fell to 23.7% on a broad-based expansion

- ▶ 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
- ▶ Employment creation is broad-based across a series of economic branches and spreading through secondary and tertiary sectors:
- ▶ In 2014 the improvement has been especially intense in Accommodation Services, Professional, Scientific & Technical activities, among other sectors

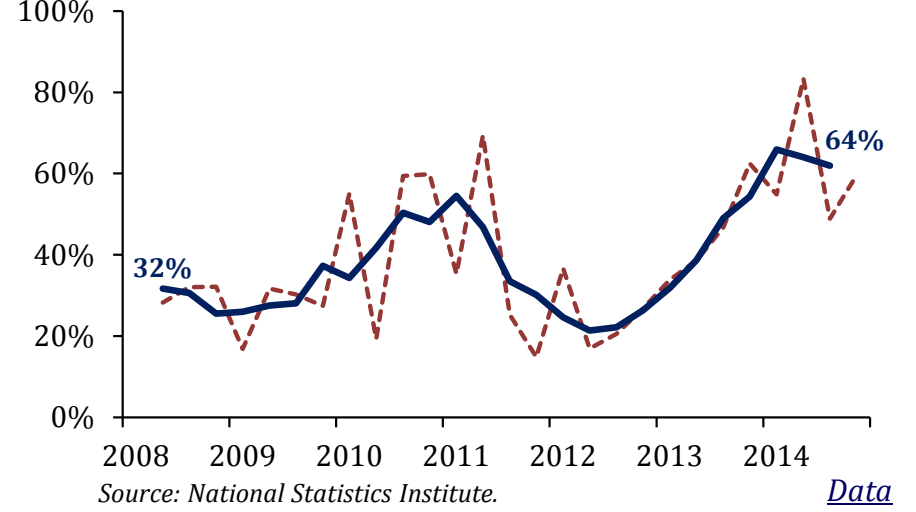
Breakdown of the Growth Rate of Unemployment into Changes in its Components: Active Population and Employment (Year-on-Year Growth Rates)



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



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



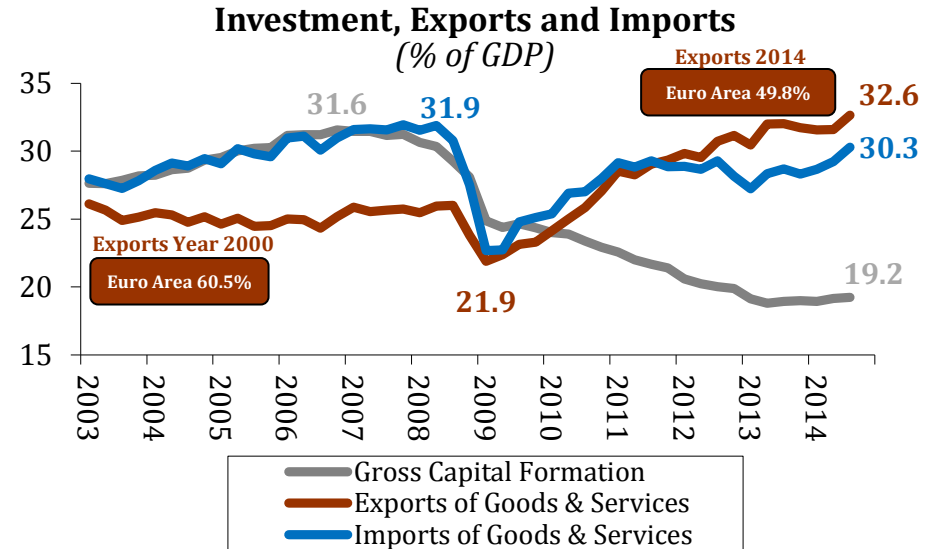
Source: National Statistics Institute.

Data



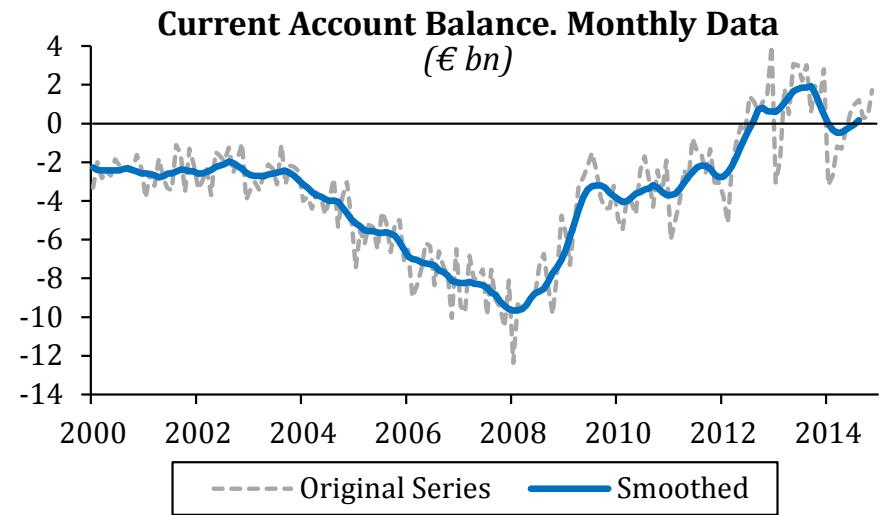
## From net borrower to net lender

- ▶ The weight of exports in GDP has increased from 21.9% in 2009Q1 to 32.6% by 2014Q3, while investment has declined substantially, from approximately 30% of GDP to 19.2% in 6 years, converging with Euro Area average
- ▶ In nominal terms, imports of goods and services are close to 2008 levels → higher capital intensity of imports and lower construction component
- ▶ In November the CA balance has moved to a surplus; increased imports linked to higher investment in capital goods has been offset by a lower oil imports bill
  - ❑ Cumulative CA & Capital Account: +0.5% of GDP
  - ❑ Goods & Services Balance: +2.4% of GDP



Source: National Statistics Institute.

[Data](#)



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

[Data](#)

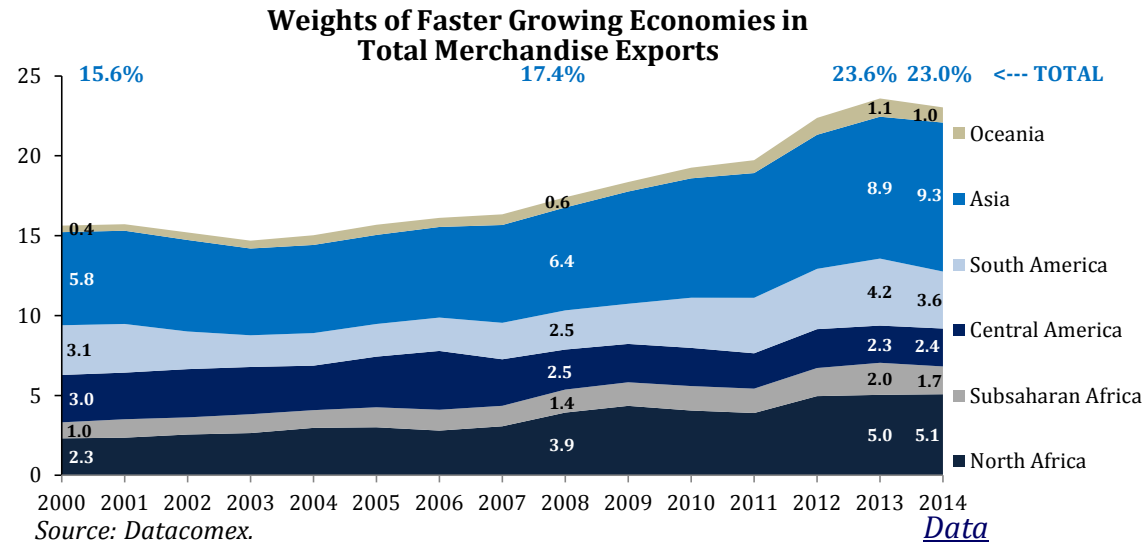
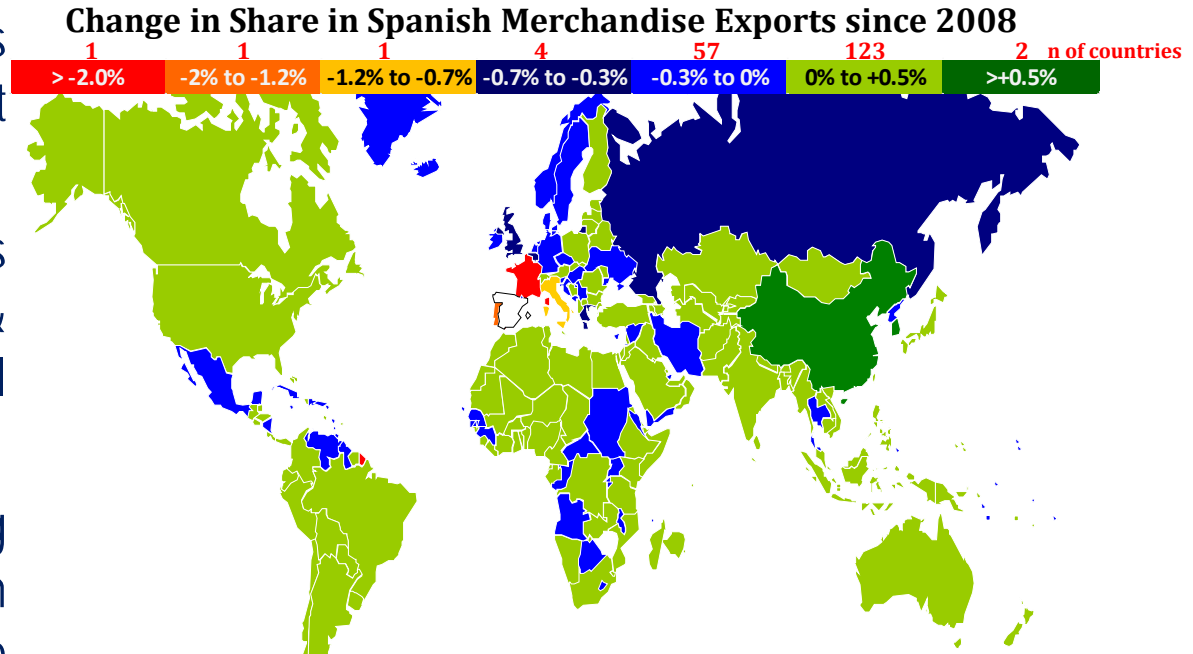
# More geographic diversification exports

► 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

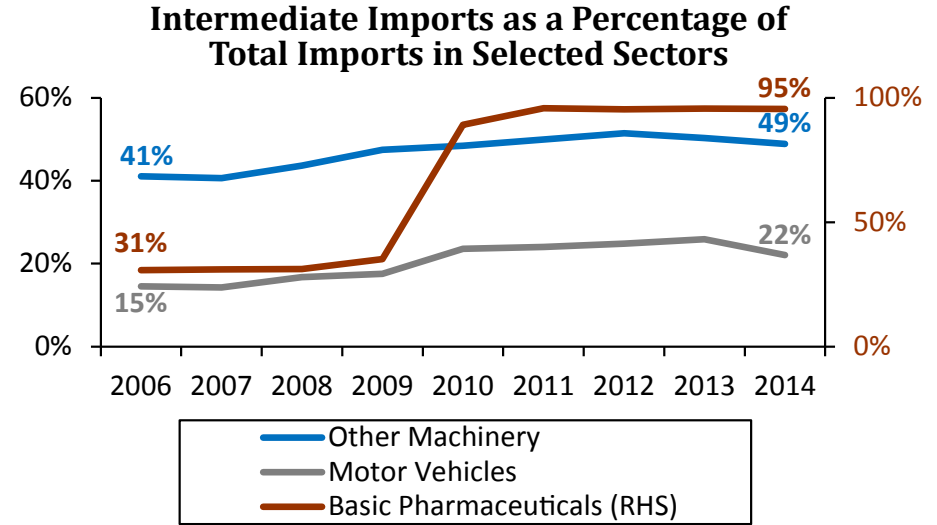
❑ The weight of faster growing economies has increased from 15.6% of total in the year 2000 to 23% by 2014

❑ Merchandise trade to the Euro Area represents 49.8% (November 2014) vs. 60.5% in the year 2000



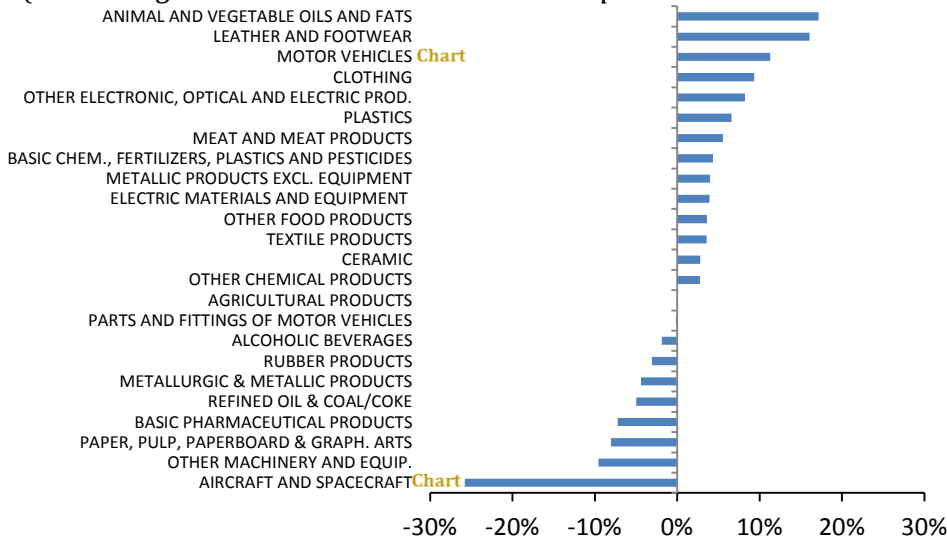
# Imports of capital goods related to increasing investment & re-exports

- ▶ Large ticket orders in 2013 in specific types of goods (Navantia, Mecca-Medina high speed rail project, etc.) impacted at the beginning of the year
- ▶ 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



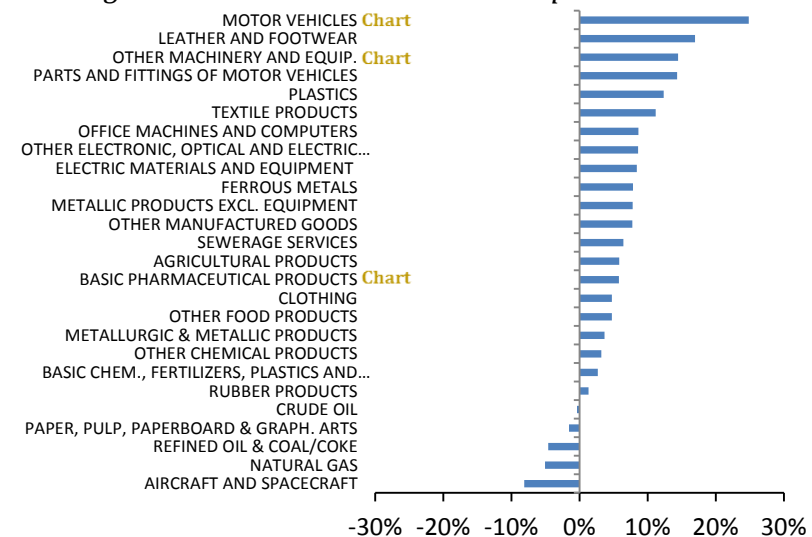
### Main Export Products (yoy)

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



### Main Import Products (yoy)

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



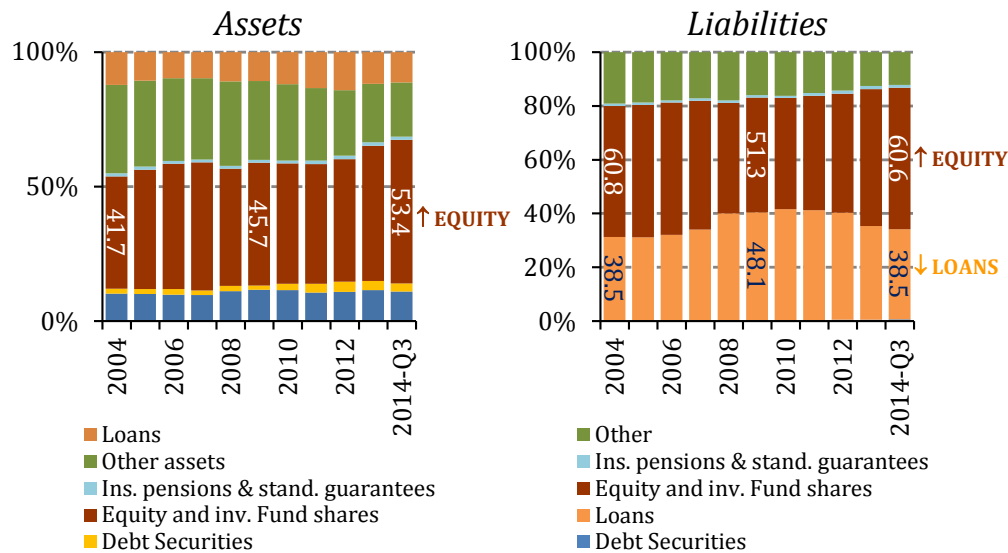
Source: Ministerio de Economía y Competitividad.

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

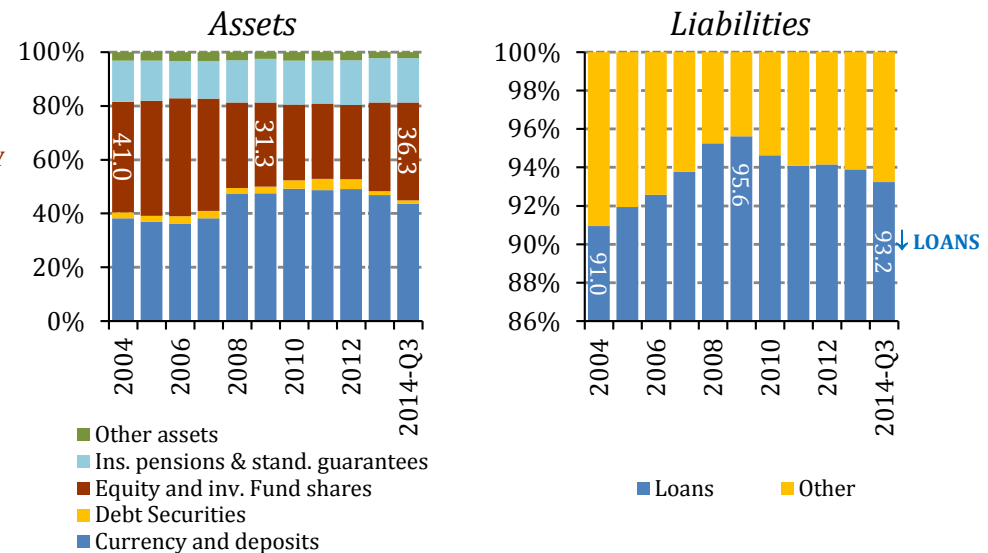
▶ The private sector is gradually switching from traditional debt to equity, in both assets and liabilities

- ❑ Non financial corporations: liabilities less intensive in loans and commercial credit, more equity. 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

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



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



Source: Bank of Spain.

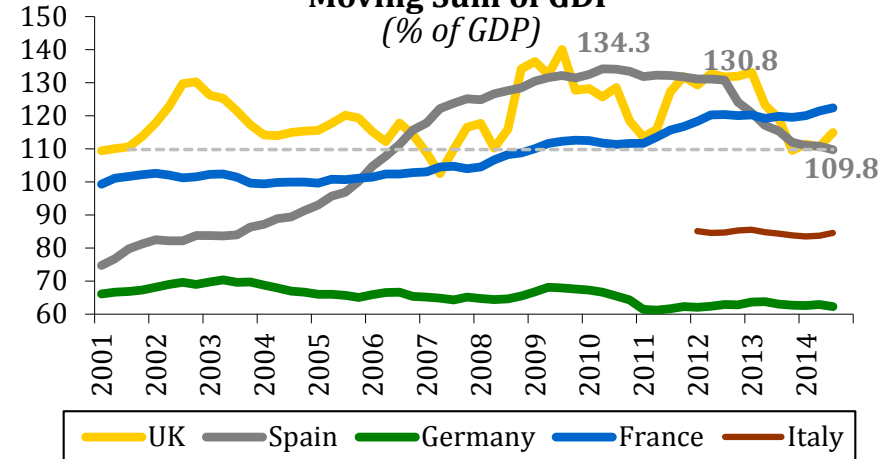
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# Deleveraging of the private sector: non-financial corporations

- ▶ Firms reduced their debt stock by c.24% of GDP.
- ▶ Non-financial accounts point into further deleveraging. 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

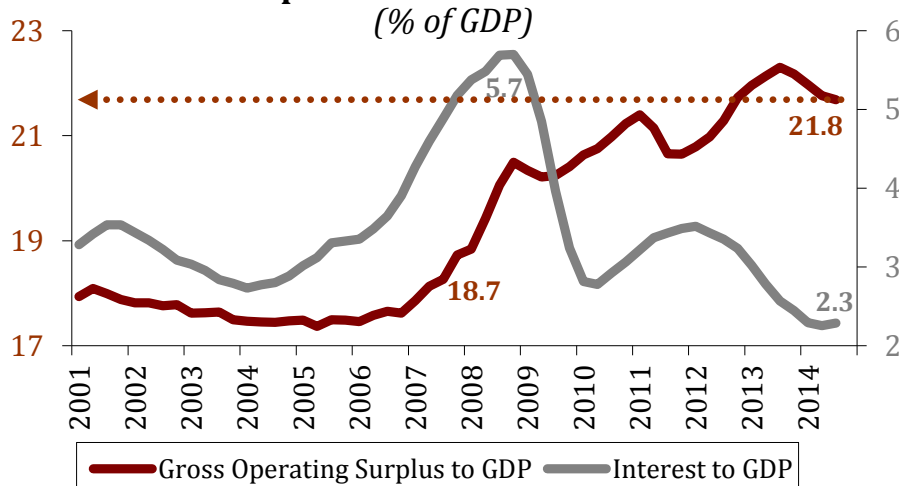
**Ratio of Debt of Non-Financial Corporations to Moving Sum of GDP**  
(% of GDP)



Source: ECB.

[Data](#)

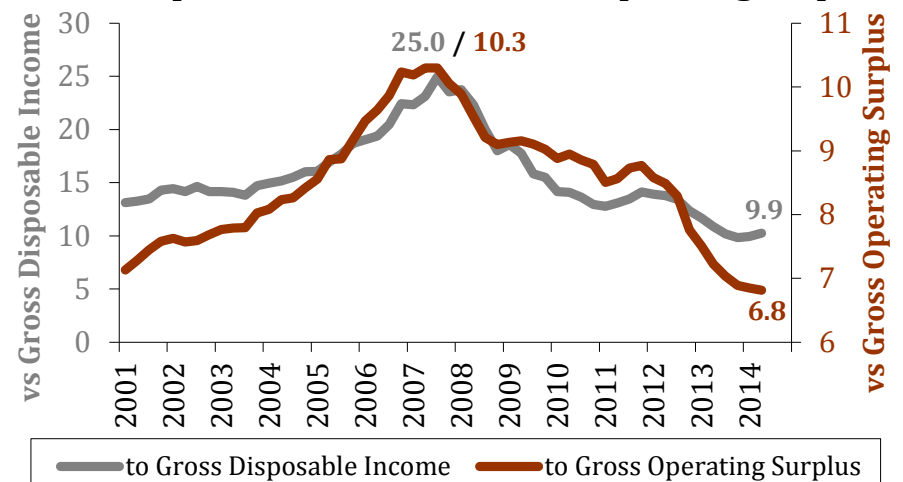
**Gross Operating Surplus of Non-Financial Corporates and Interest Paid**  
(% of GDP)



Source: National Statistics Institute.

[Data](#)

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



Source: National Statistics Institute and Bank of Spain.

[Data](#)

# Households delever despite increasing consumption expenditure

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

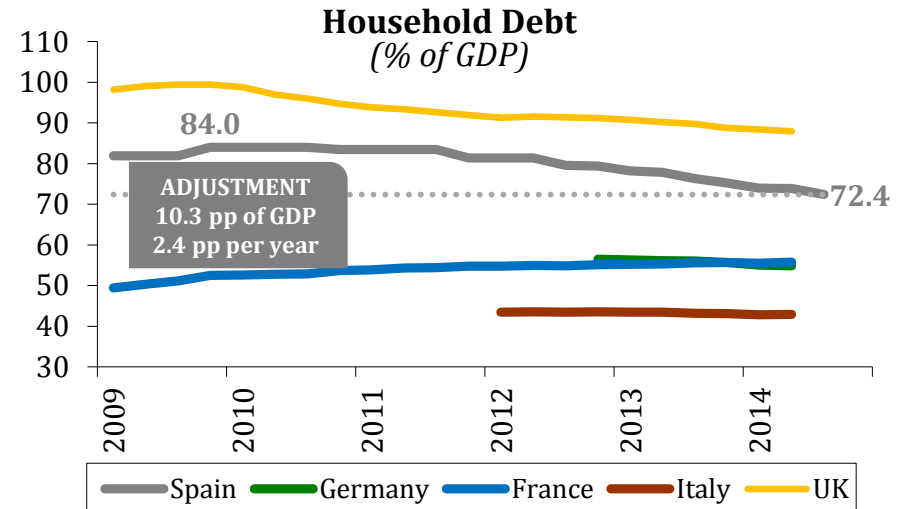
☐ Debt/GDP of Spanish households has declined from 84.0% in 2009Q4 to 72.4% by 2014Q3

▶ While household consumption expenditure has continued to accelerate in 2014 the rate of decline in debt has continued its declining path

▶ Projections of existing mortgage debt amortisation schedules point in the direction of a fast deleveraging process

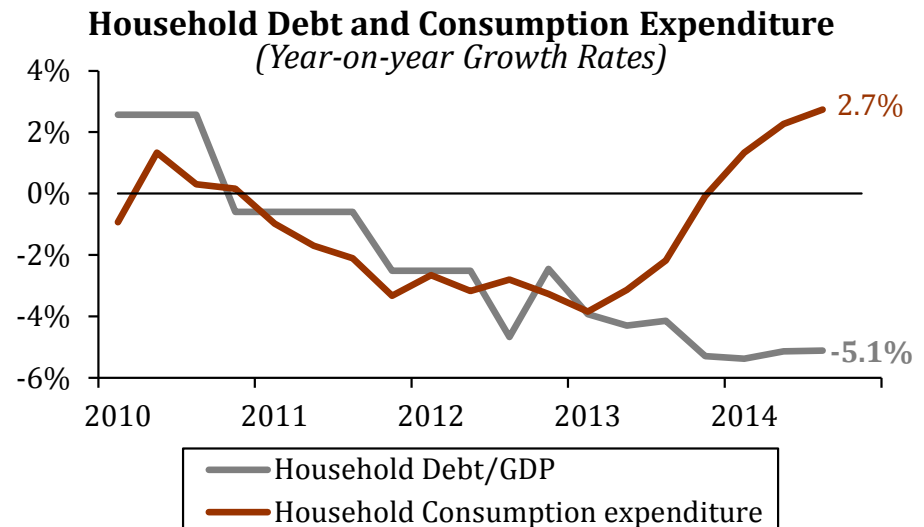
☐ By 2018 the Household Debt/GDP ratio will be in line with the current ratios of Germany or France

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



Source: ECB & Bank of Spain.

[Data](#)



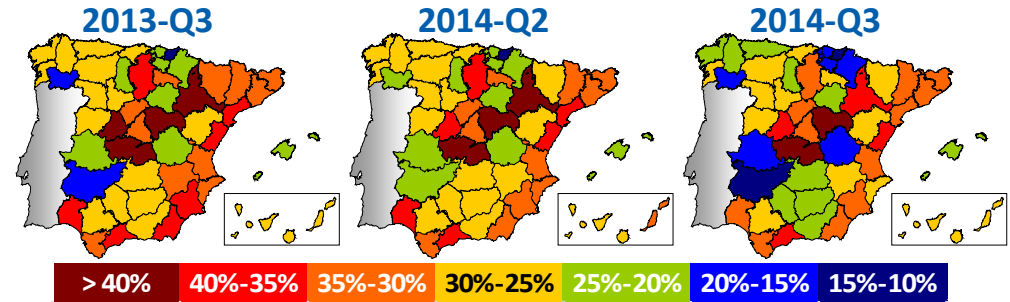
Source: Bank of Spain and National Statistics Institute.

[Data](#)

# The construction sector shows signs of stabilisation

- ▶ The price adjustment has been very heterogeneous and more intense around most populated and coastal provinces
- ▶ House transactions have picked up in a series of provinces as prices are bottoming out
- ▶ Significantly more houses sold than started or finished: gradual reduction of unsold stock

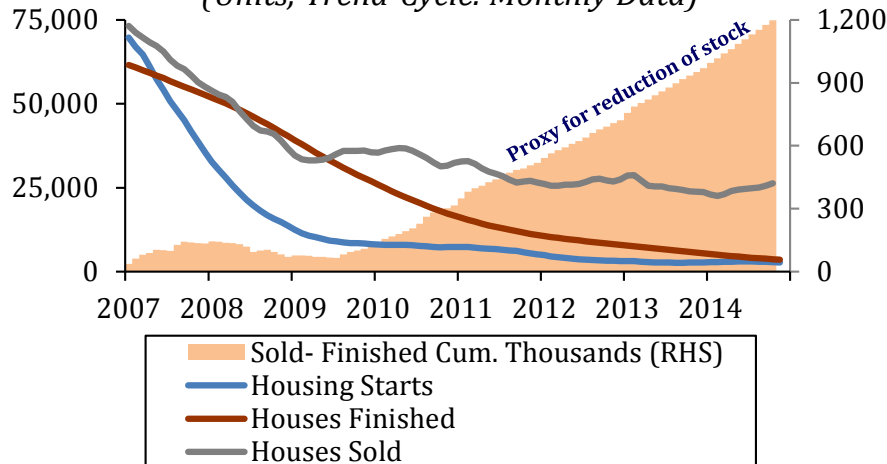
Nominal Housing Price Adjustment Since the Peak in Each Province (In percent)



Source: Ministerio de Fomento.

[Data](#)

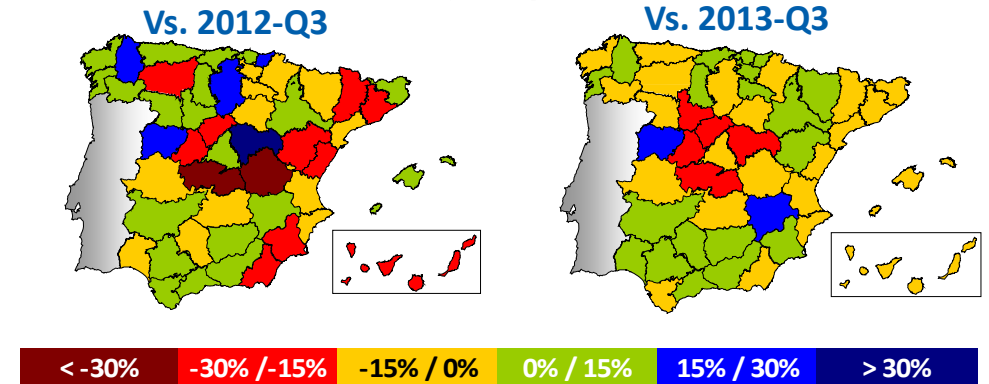
Monthly Houses Started, Finished and Sold (Units, Trend-Cycle. Monthly Data)



Source: Ministerio de Economía y Competitividad.

[Data](#)

Number of Housing Transactions in 2014Q3 in Each Province (Change, in percent)



Source: National Statistics Institute.

[Data](#)

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

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

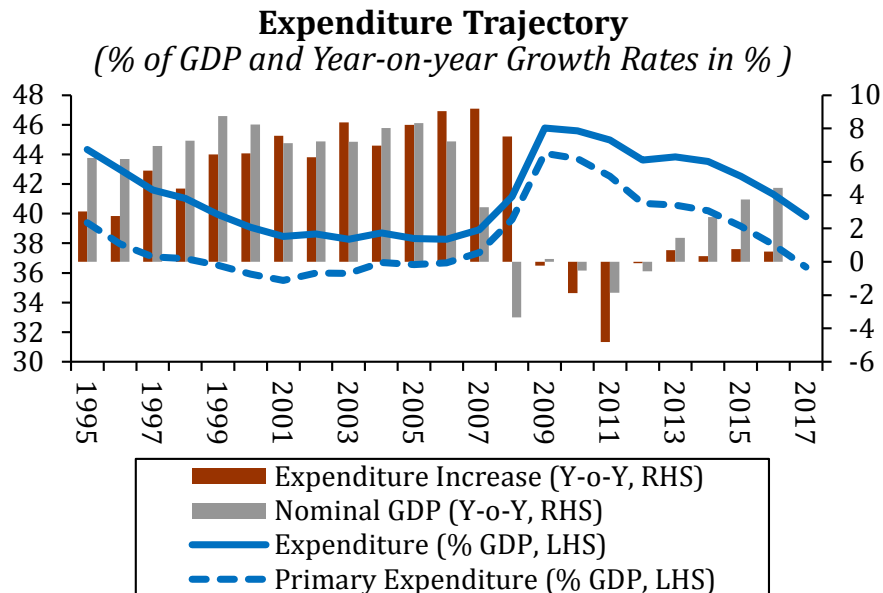


# The Central Government Budgets for 2015

- ▶ 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
- ▶ In 2014 the tax base has increased for the first time since 2007, in line with economic growth

[Links to detailed information \(Spanish\):](#)

[Presentation](#)  
[Draft Budgetary Plan](#)



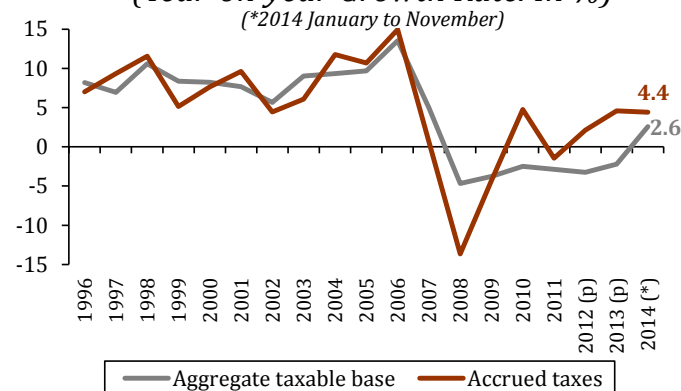
Source: Ministerio de Hacienda y Administraciones Públicas.

| 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        |
| <b>TOTAL</b>                        | <b>-3,803</b> | <b>-5,256</b> | <b>-9,059</b> |

↓ + 2<sup>nd</sup> round effects

## Aggregate Taxable Base and Accrued Taxes

(Year-on-year Growth Rate. In %)



## Tax Collection by Item

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

Source: Ministerio de Hacienda y Administraciones Públicas.

[Data](#)

# The fiscal path of the Public Administrations 2014-2017

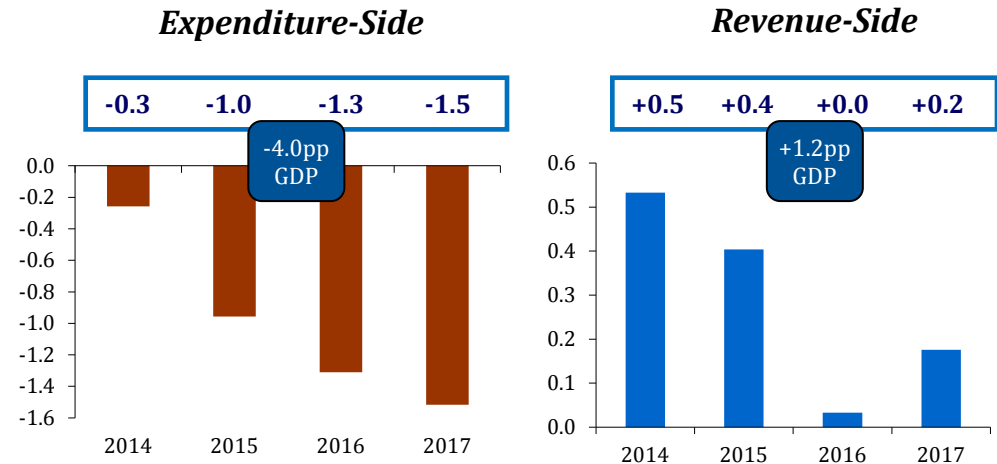
- ▶ 2014 deficit target revised down to 5.5% of GDP in April
- ▶ Emphasis on expenditure reduction (4pp of GDP between 2014 and 2017); mainly driven by efficiency gains in the Public Administrations
- ▶ Incorporates impact on tax collection of the tax reform (2015-2016 total: ex-ante approx. €9.1 bn;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

| Net Lending(+)/Borrowing(-) of the General Government.<br>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         |
| <b>General Government</b>   | <b>-6.33</b> | <b>-5.5</b> | <b>-4.2</b> | <b>-2.8</b> | <b>-1.1</b> |
| <b>Primary Balance</b>  | <b>-3.1</b>  | <b>-2.2</b> | <b>-0.8</b> | <b>0.6</b>  | <b>2.3</b>  |
| <b>Nominal Adjustment</b>   | <b>0.3</b>   | <b>0.8</b>  | <b>1.4</b>  | <b>1.3</b>  | <b>1.7</b>  |
| <b>Financial Sector one-offs</b>  | <b>0.5</b>   | <b>0.1</b>  | <b>-</b>    | <b>-</b>    | <b>-</b>    |

Source: Ministerio de Economía y Competitividad.

[Data](#)

Changes to the fiscal balance  
(% of GDP)

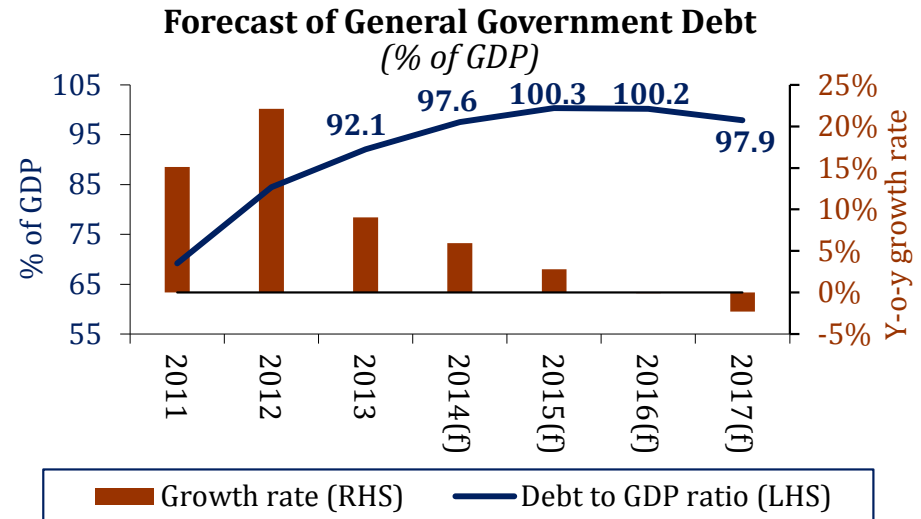


Source: Ministerio de Economía y Competitividad.

[Data](#)

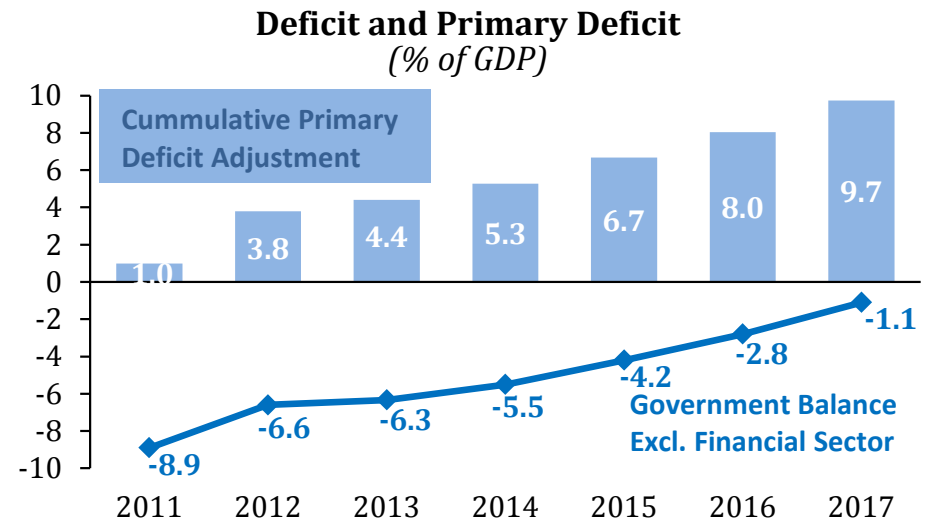
# Debt/GDP dynamics 2014-2015

- ▶ Frontloaded deficit adjustment in 2012-2014
- ▶ 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 (November 2014 data): the combined deficit of the Central Government Administration & autonomous entities of the Central Govt. reached €34.3 bn

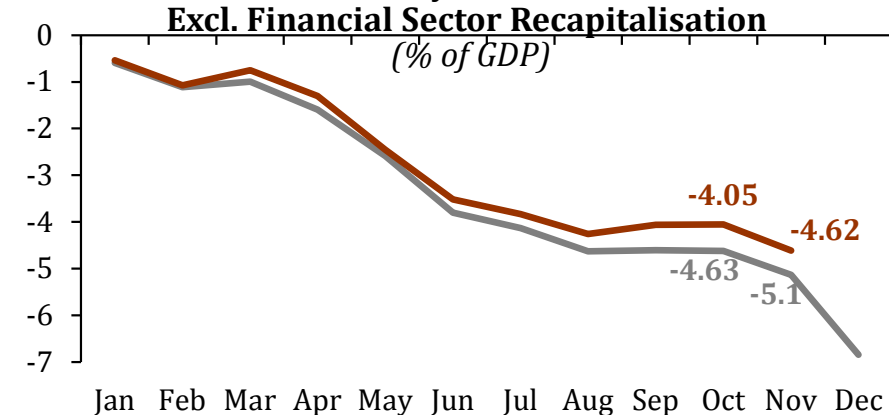
▪ Central Govt. Administration (November 2014 data): deficit €36.0 bn vs. €39.6 bn in November 2013; primary deficit down to €8.5bn vs. €13.5 bn in November 2013

- ✓ Revenue increased by 4.0% y-o-y
- ✓ Expenditure increased by 1.3% y-o-y

❑ Regional Governments (November 2014 data): deficit reached €14.6 bn

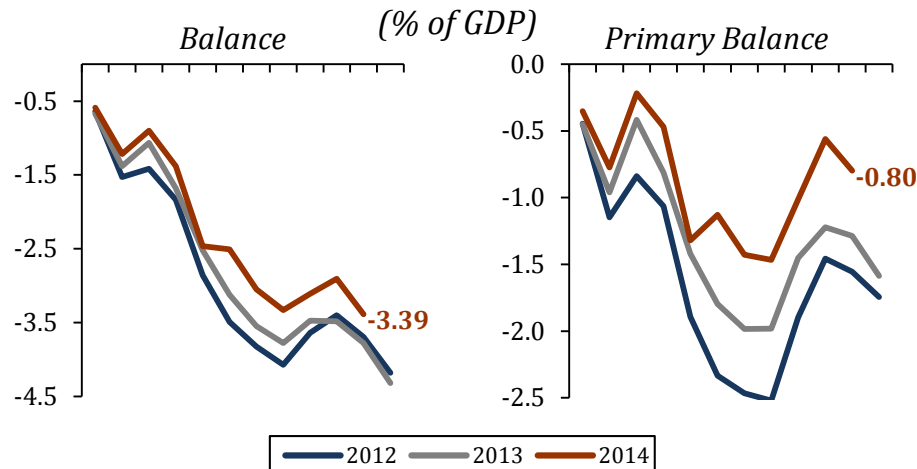
❑ Social Security Administrations (November 2014 data): the Social Security posted a deficit of €0.9 bn

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



Source: IGAE. — 2013 — 2014 [Data](#)

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



Source: IGAE. Up to November 2014. [Data](#)

# STRUCTURAL REFORMS

# Three years of structural reforms

## 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

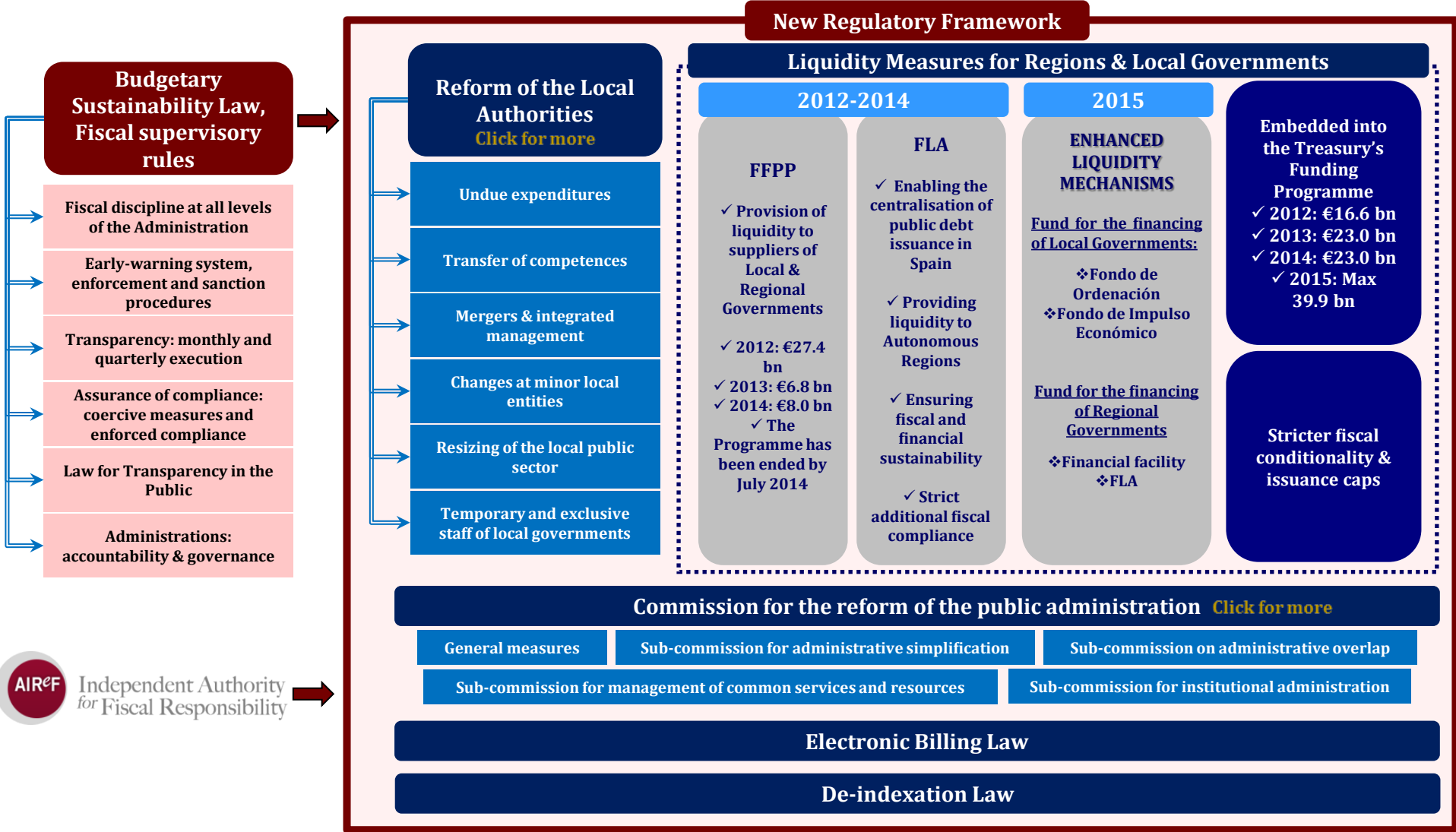
- Economic Structural Reforms
- Public Sector Reforms
- Financial Sector Reforms

Links to detailed presentations describing the Reform Agenda

*Balance Reforms. Three years in Government*  
*OECD: CORA Reforms*

# 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<br>2 Com. Ling |
| Education       | ✓                         | ✓              | ✓               | ✓                         |                             | ✓          |                          |
| Health          | ✓                         | ✓              | ✓               | ✓                         | ✓                           |            | ✓                        |
| Transport       | ✓                         | ✓              | ✓               | ✓                         | ✓                           | ✓          |                          |
| Economy         | ✓                         | ✓              | ✓               | ✓                         | ✓                           | ✓          |                          |
| Justice         | ✓                         | ✓              | ✓               |                           |                             |            |                          |
| Universities    | ✓                         |                | ✓               |                           |                             |            |                          |
| Police          | ✓                         |                | ✓               |                           |                             |            |                          |
| Infrastructures | ✓                         | ✓              | ✓               | ✓                         |                             |            |                          |
| Environment     | ✓                         | ✓              |                 | ✓                         |                             | ✓          |                          |
| Housing         | ✓                         | ✓              |                 | ✓                         | ✓                           |            |                          |
| Local Entities  | ✓                         | ✓              |                 | ✓                         |                             |            |                          |
| Culture         | ✓                         |                |                 |                           |                             | ✓          | ✓                        |
| Tourism         | ✓                         |                |                 |                           |                             | ✓          |                          |
| Employment      | ✓                         |                |                 |                           |                             | ✓          |                          |
| Social Services | ✓                         |                |                 |                           |                             |            |                          |

| Autonomous Community | FLA (€ bn)<br>(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

- ▶ 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

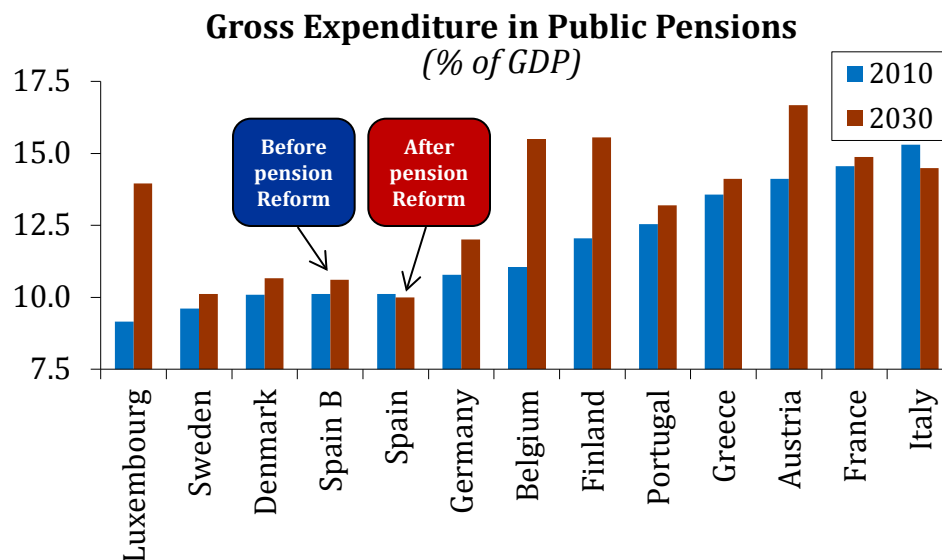
| Changes to Personal Income Tax  | Changes to Tax on Capital   | Changes to Corporate Income Tax   | VAT   | Fight Against Tax Fraud  | R&D and cultural investment  |
|---|---|---|---|--|--|
| <ul style="list-style-type: none"> <li>▶ Reduction in number of tranches and rates in two years</li> </ul>  | <ul style="list-style-type: none"> <li>▶ Lower rates in two years and more progressive</li> </ul>   | <ul style="list-style-type: none"> <li>▶ Reduced general rate: from 30% to 25% in two years (reduced rate for new firms 15%)</li> </ul>   | <ul style="list-style-type: none"> <li>▶ Health care products VAT rate adapted to ECC regulations:</li> <li>- Intermediate products for drug development, medical instruments and equipment, medical devices and pharmaceutical products</li> </ul> | <ul style="list-style-type: none"> <li>▶ Lists of defaulters to be published</li> </ul>  | <ul style="list-style-type: none"> <li>▶ Extension of partial exemption (85%) of the tax on electricity. Exemptions extended to all productive processes in which the costs of electricity exceeds 50% of production costs</li> </ul>  |
| <ul style="list-style-type: none"> <li>▶ Modification of personal income allowance:                             <ul style="list-style-type: none"> <li>- Higher personal income minima</li> <li>- Family tax deductions: enabling negative tax rates for large families and with dependent persons with serious disabilities</li> </ul> </li> </ul> | <ul style="list-style-type: none"> <li>▶ Elimination of tax deduction for dividends</li> <li>▶ Capital gains generated in less than 12 months no longer penalised</li> </ul>                  | <ul style="list-style-type: none"> <li>▶ In the case of the financial sector kept at 30% (out for credit cooperatives and "Cajas Rurales")</li> </ul>   |   | <ul style="list-style-type: none"> <li>▶ Annual publication of tax havens</li> <li>Tax audit process: New deadlines and suspension of Statutes of Limitation in specific situations</li> </ul> |  |
| <ul style="list-style-type: none"> <li>▶ Limits to exemptions to severance payments in case of unjustified dismissal</li> </ul>   | <ul style="list-style-type: none"> <li>▶ New savings instrument: savings or insurance schemes maintained longer than five years ('Cuenta Ahorro 5'): exempt from capital gains tax</li> </ul> | <ul style="list-style-type: none"> <li>▶ Update and simplification of depreciation tables</li> </ul>  | <ul style="list-style-type: none"> <li>▶ New rules on the localisation of assets; taxing at destination of electronic, telecommunications and radio-television services when the addressee is a private individual</li> </ul>                       | <ul style="list-style-type: none"> <li>▶ Administrative assessment in evidence of tax fraud</li> </ul>   | <ul style="list-style-type: none"> <li>▶ Substitution of deductions in CIT                             <ul style="list-style-type: none"> <li>● Deductions eliminated:                                     <ul style="list-style-type: none"> <li>- Environmental investments</li> <li>- Expenses for vocational training</li> </ul> </li> <li>- Reinvestment of extraordinary benefits                                     <ul style="list-style-type: none"> <li>● New deductions (favouring the deleveraging process):</li> </ul> </li> <li>- Capitalisation reserves. 10% of corporate income deductible if incorporated into reserves.                                     <ul style="list-style-type: none"> <li>- Equalisation reserve for SMEs</li> <li>● Limits to the financial expenditure deductions (favouring the deleveraging process, reduced to 30% of gross operating profit)</li> </ul> </li> </ul> </li> </ul> |
| <ul style="list-style-type: none"> <li>▶ Tax deductions for house rental:                             <ul style="list-style-type: none"> <li>- Elimination for new rentals (Expenditure side)</li> <li>- Lower tax deductions for house rentals (Income side)</li> </ul> </li> </ul>  |   |   |   | <ul style="list-style-type: none"> <li>▶ Limit for deductible contributions linked to pension plans lowered to €8,000/year</li> </ul>  |  |
| <ul style="list-style-type: none"> <li>▶ Lower tax withholding for professional and self-employed workers with incomes below €15,000</li> </ul>   | <ul style="list-style-type: none"> <li>▶ Better fiscal treatment in case of assets received in lieu of payment if affected by preference shares</li> </ul>                                    | <ul style="list-style-type: none"> <li>▶ Limit to offset tax losses: 50%/25% depending on revenue in 2015; 60% in 2016 and 70% from 2017 onwards.</li> <li>▶ To maintain income from the CIT, in 2015 previous measures maintained</li> </ul> | <ul style="list-style-type: none"> <li>▶ Better precision in the indirect assessment regime</li> </ul>  | <ul style="list-style-type: none"> <li>▶ Interruption of the limitation period of related tax obligations</li> </ul>   | <ul style="list-style-type: none"> <li>▶ Incentives for cultural activities</li> </ul>   |
| <ul style="list-style-type: none"> <li>▶ Limits to simplified method ('Modulos') to certain professional activities</li> </ul>  |   |   |   |  |  |

# The Pension System reform reduces the impact of population ageing

► Building on the 2011 reform which already introduced measures to adapt the pension system, in March 2013 a Royal Decree was presented in order to foster active ageing, increasing the effective retirement age

► In December 2013 the Pension System Reform was approved. It introduces two factors to which pensions will be linked:

- ❑ 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

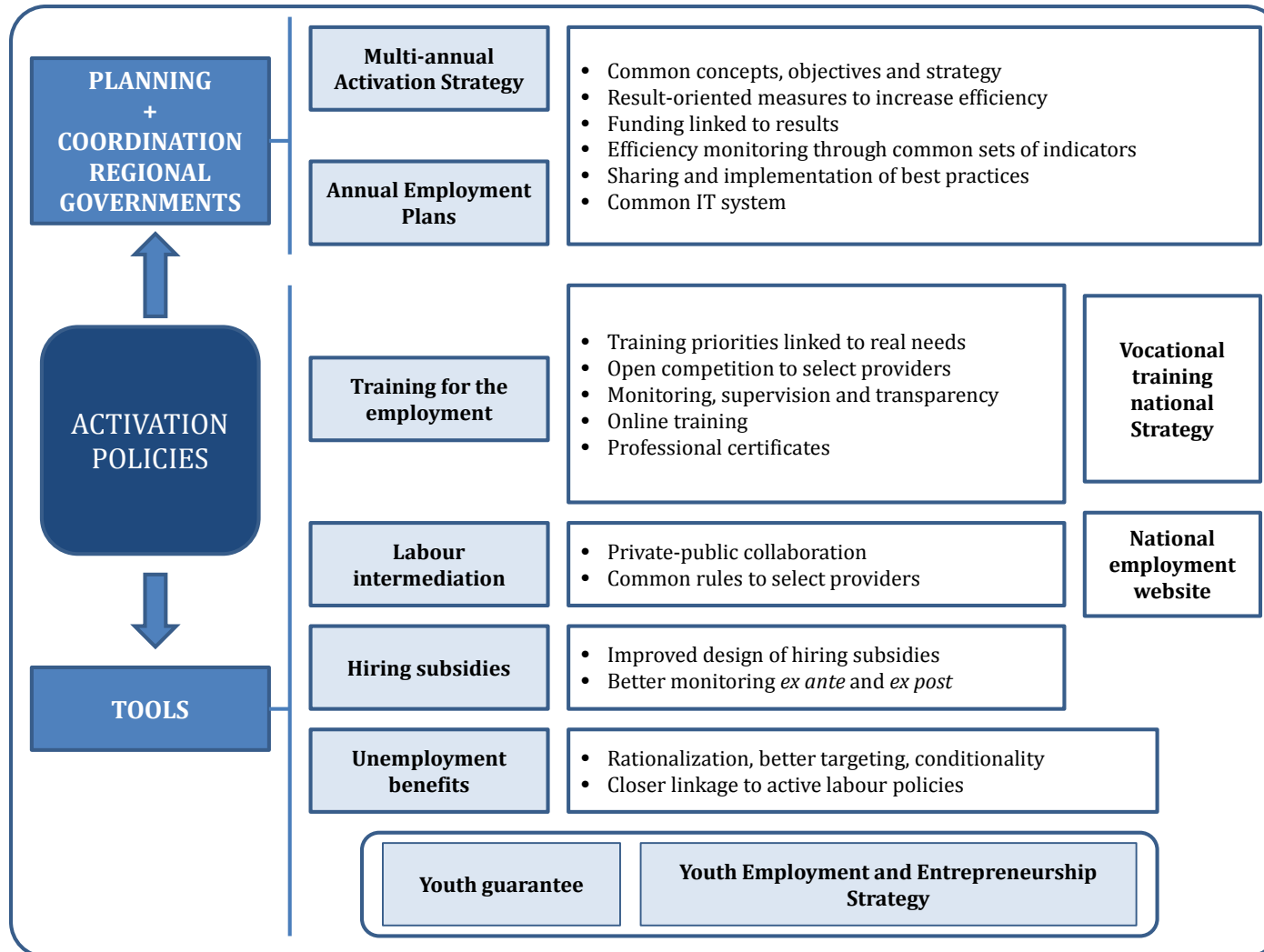
# The labour market reform addresses Spain's most important imbalance

► 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"> <li>→ Dynamic bargaining more responsive to the needs of businesses and workers</li> </ul>  | <ul style="list-style-type: none"> <li>→ Avoiding lay-offs: rigidity fostered job cuts as a means of adjusting to economic changes</li> <li>→ Lack of flexibility avoided innovation and gains in competitiveness</li> </ul>  | <ul style="list-style-type: none"> <li>→ Reduction of severance pay for unfair dismissals</li> </ul>   | <ul style="list-style-type: none"> <li>① Crisis contract: new contract for entrepreneurs aimed at small businesses. It has a one-year trial period. Tied to employment tax breaks and fiscal tax credit, specially for hiring young workers. Breaks and credits are designed to limit the dead-weight effect</li> <li>② Training and skill building: deep regulatory modifications to provide a structural change and develop a dual training system that allows a balance of training and work</li> <li>③ Flexible regulation of telework</li> <li>④ Part-time contract: increased flexibility, allowing overtime</li> </ul> |
| <ul style="list-style-type: none"> <li>→ Move beyond the model of indexing salaries and wages</li> </ul>   | <ul style="list-style-type: none"> <li>→ Clear and objective regulatory framework of fair dismissals</li> </ul>   | <ul style="list-style-type: none"> <li>→ Clear and objective regulatory framework of fair dismissals</li> </ul>  |   |
| <ul style="list-style-type: none"> <li>→ Balanced regulatory framework in line with economic circumstances</li> </ul>  | <ul style="list-style-type: none"> <li>① Classification of workers based on skills not on professional occupations</li> <li>② Simplification of rules for the reallocation of workers</li> <li>③ Streamlining the adoption of significant changes in working conditions</li> <li>④ Furloughs/Time-reductions if legitimate financial, productive or organisational reasons exist</li> <li>⑤ Distribution of working-time</li> </ul> | <ul style="list-style-type: none"> <li>① Severance pay for unfair dismissal down to 33days/Max 24months of salary vs. 45days/Max 42 months</li> <li>② Clarification of fair dismissal causes (20days/Max 12 Mo)</li> <li>③ Removal of administrative authorisation for collective layoffs</li> <li>④ Elimination of procedural salaries</li> <li>⑤ Fair dismissals for economic causes of civil servants</li> <li>⑥ Streamlining of dismissals based on absenteeism</li> </ul> |   |
| <ul style="list-style-type: none"> <li>① Opting out from higher-level agreements</li> <li>② Priority of company-level agreements</li> <li>③ Limiting the statutory extension rule of expired agreements up to one year (unlimited before)</li> </ul> |   |  |   |

# Activation policies & fight against unemployment

► Activation policies complement the labor reform. Spain has reformed its public employment services and launching new tools to fight against unemployment



# 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

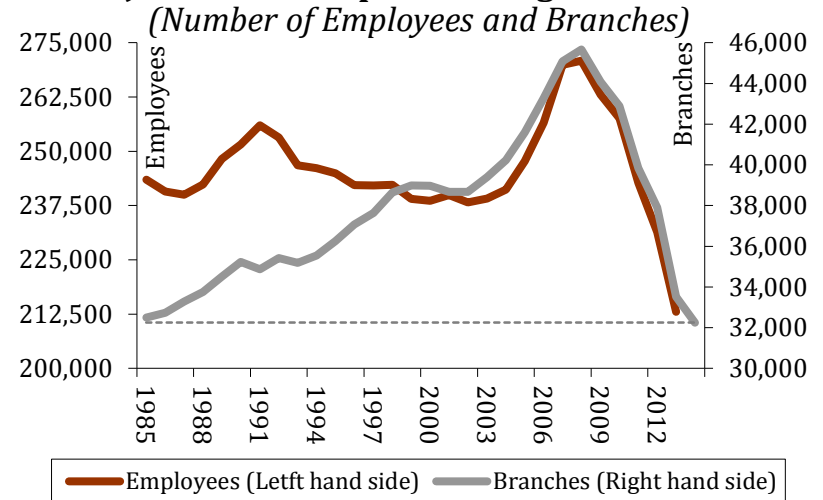
| Initial steps: 2009-Mid 2013 |  |   |
|------------------------------|--|---|
| 2009-2011                    | <b>FROB I</b><br>Reform of the Legal Framework of Cajas<br>Integration of Cajas via "Institutional Protection Schemes" and Capital Injections/Asset Protection Schemes |   |
|                              | <b>FROB II</b>   |   |
| 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"> <li><input type="checkbox"/> Access to banking credit</li> <li><input type="checkbox"/> Securitisation</li> <li><input type="checkbox"/> Access to non-bank financing</li> </ul> |     |

# 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 2014Q3

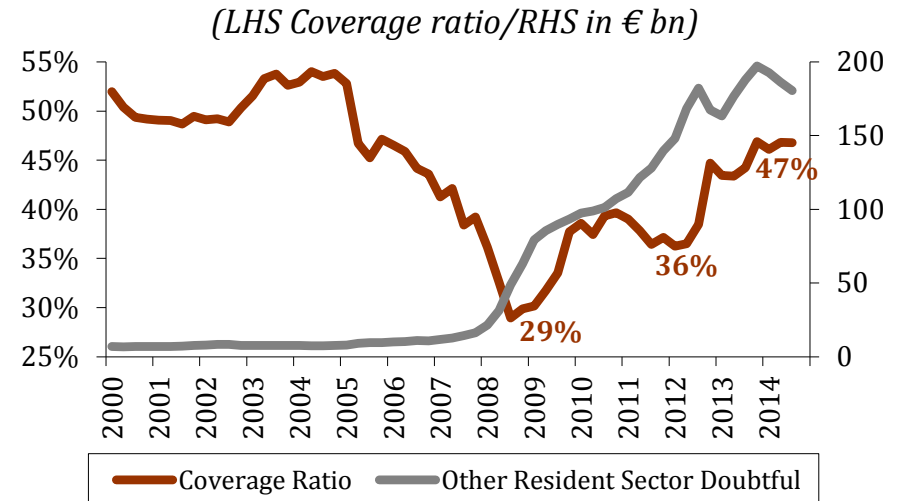
**Adjustment in Deposit Taking Institutions**



Source: Bank of Spain.

[Data](#)

**Doubtful Loans. Other Resident Sector**



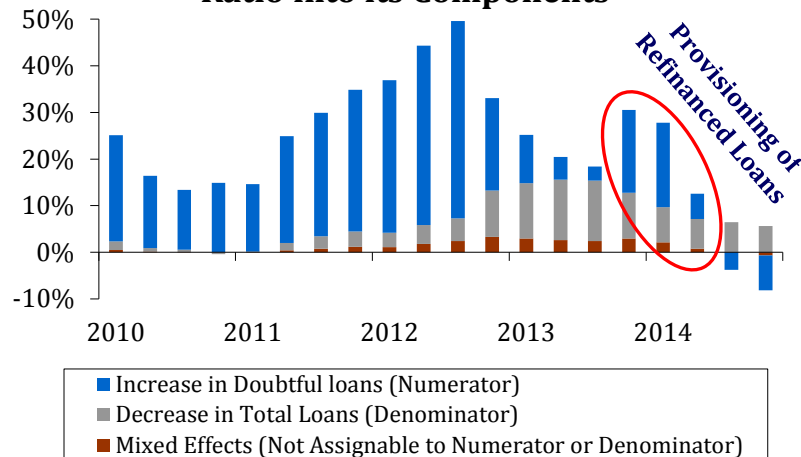
Source: Bank of Spain.

[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 2014-Q3 doubtful loans have registered their first negative yoy rate since 2004
- ▶ Improving equity-to-asset ratio and funding gap

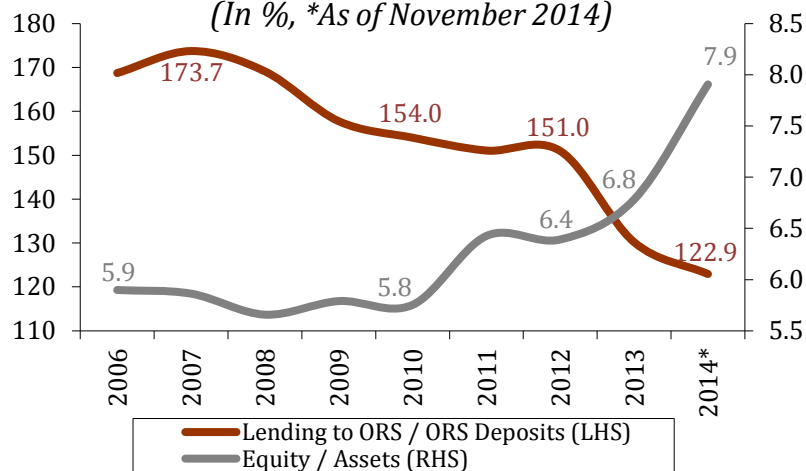
**Breakdown of Year-on-Year Growth Rate of NPL Ratio into its Components**



Source: Bank of Spain.

\* Last: November 2014 over November 2013

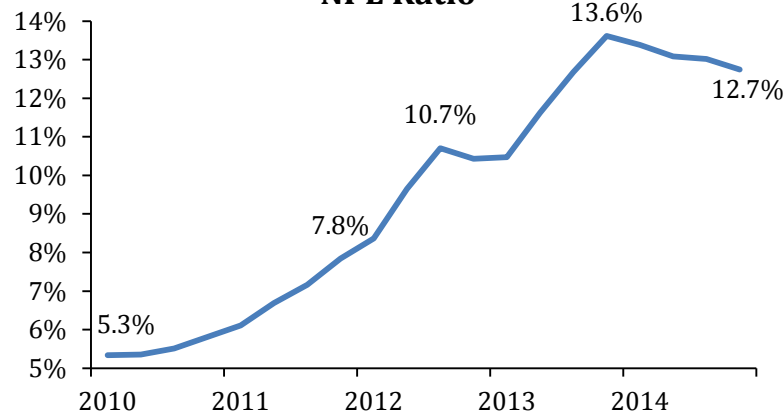
**Equity-to-Assets and Lending-to-Deposits Ratios**  
(In %, \*As of November 2014)



Source: Bank of Spain.

[Data](#)

**NPL Ratio**



Source: Bank of Spain.

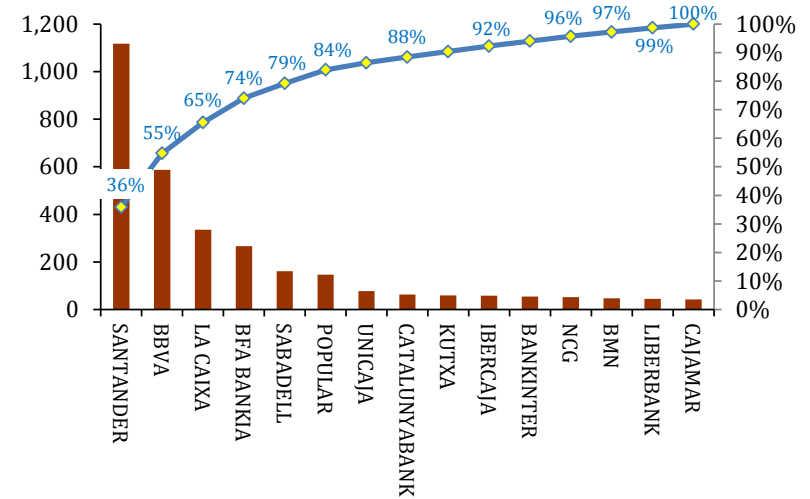
\* November 2014 over November 2014

[Data](#)

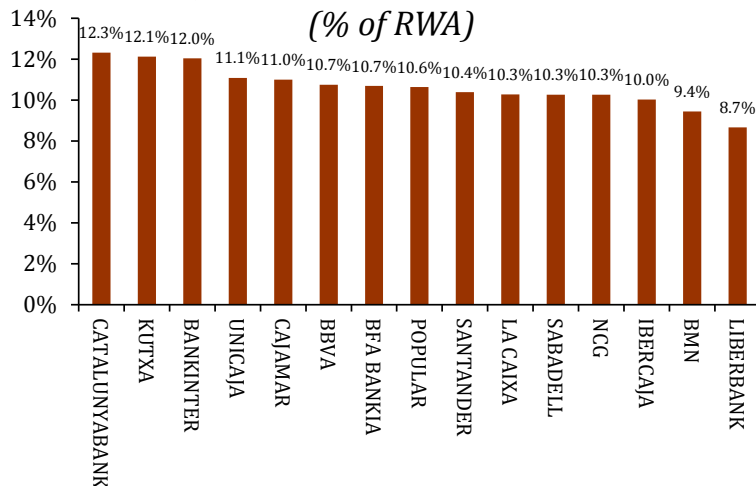
# Spanish Banks: into the Comprehensive Assessment of the ECB

- ▶ 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

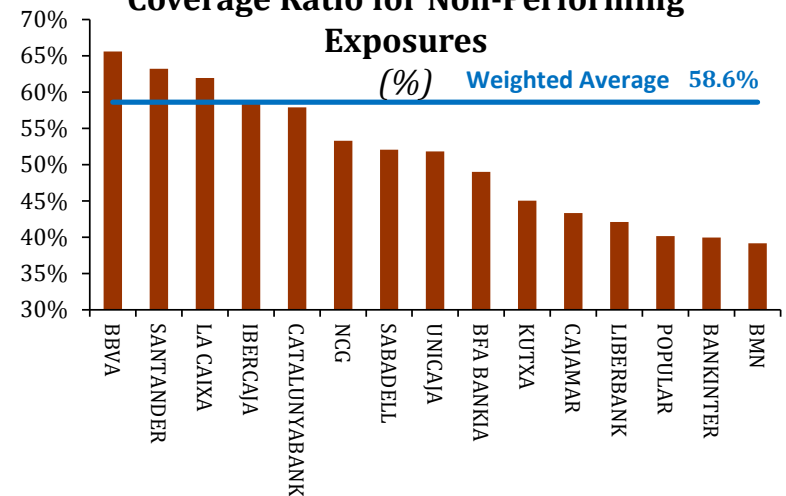
**Spanish Banks: Size in €bn (LHS) and Cumulative Percentage of Analysed Assets (RHS)**



**Starting CET1 as of December 31<sup>st</sup> 2013 (% of RWA)**



**Coverage Ratio for Non-Performing Exposures (%)**



Source: Bank of Spain.

Data



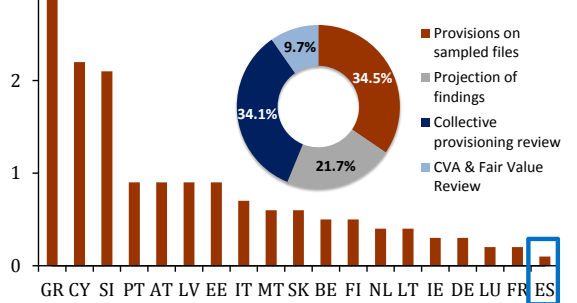
# Results of the comprehensive assessment : AQR & stress tests

► 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

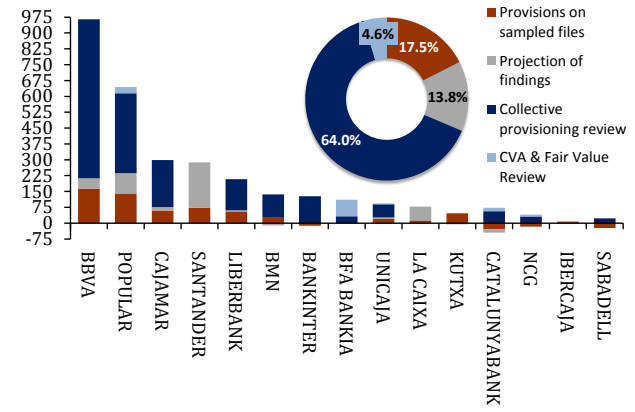
► The adverse scenario entails a substantial worsening of the Spanish economy, both in terms of growth and employment. The total net decline in capital arising from the stressed scenario amounts to 17.2 bn, i.e. 1.4pp of CET1 (vs. 3pp for the whole SSM)

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

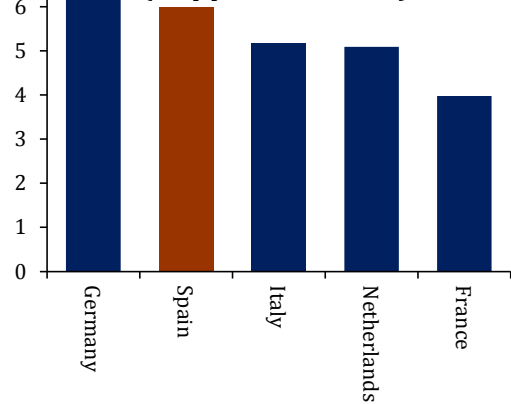
**SSM: Gross Adjustments in the AQR**  
(% of RWA and % of total)



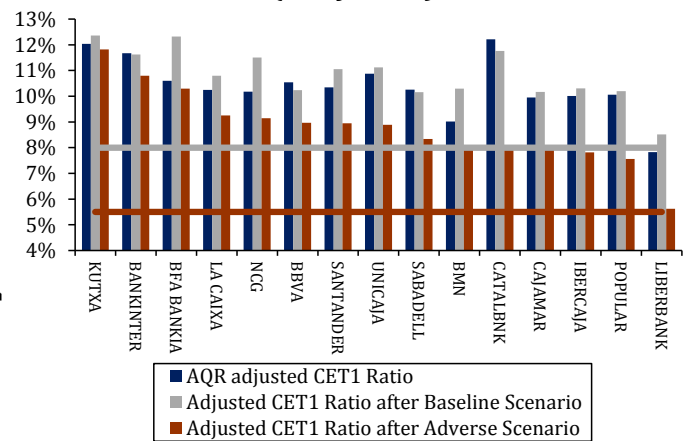
**Spain: Breakdown of Gross Adjustments in the AQR**  
(€ mn and % of total)



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

**2. Spanish Economic Policy**

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

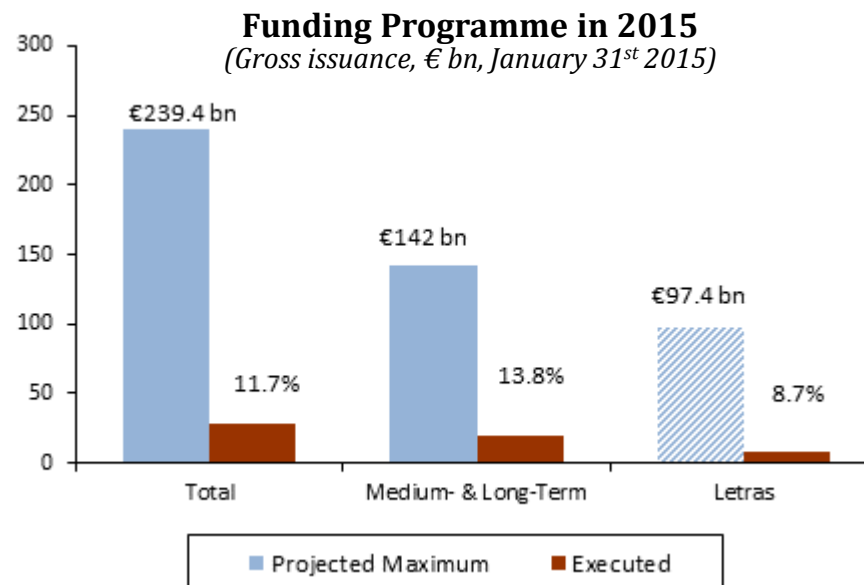
# The Treasury's Funding Programme for 2015

- ▶ The net funding target will be 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 €28 bn so far in 2015
- ▶ Up to January 31<sup>st</sup> the Spanish Treasury has funded €19.6 bn, a 13.8% of the expected amount of the regular medium- and long-term gross issuance, and €8.5 bn, a 8.7% of Letras

| <i>(in billion euros and in effective terms)</i> | <i>Pro Memoria: End 2014</i> | <b>2015 Strategy</b> |
|--|------------------------------|----------------------|
| <b>Total Net Issuance</b>                        | <b>55.641</b>                | <b>55.000</b>        |
| <b>Total Gross Issuance</b>                      | <b>241.333</b>               | <b>239.369</b>       |
| <b>Medium- and Long-term<sup>1</sup></b>         |                              |                      |
| Gross Issuance                                   | 142.230                      | 141.996              |
| Amortisation                                     | 76.176                       | 91.996               |
| Net Issuance                                     | 66.054                       | 50.000               |
| <b>Letras del Tesoro<sup>2</sup></b>             |                              |                      |
| Gross Issuance                                   | 99.103                       | 97.373               |
| Amortisation                                     | 109.516                      | 92.373               |
| Net Issuance                                     | -10.413                      | 5.000                |

<sup>1</sup> Includes debt in other currencies, Bonos & Obligaciones, and assumed debts

<sup>2</sup> Redemptions of Letras, and therefore also gross issuance, will depend on the Letras issuance strategy in 2015



## The Treasury's Funding Programme for 2015

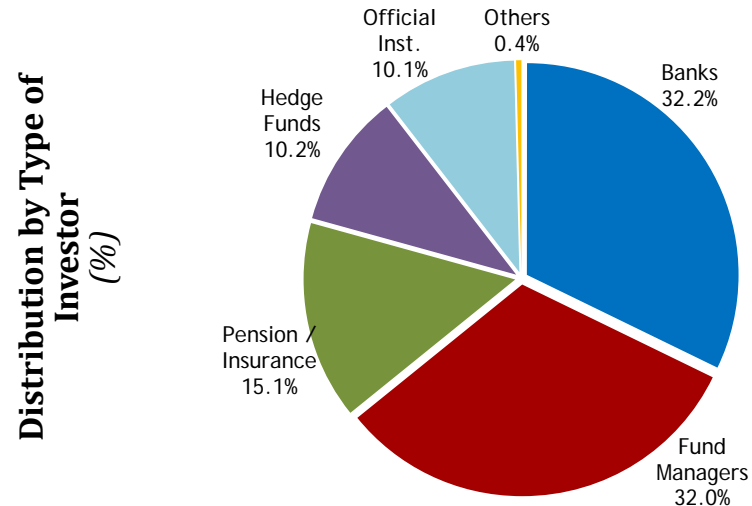
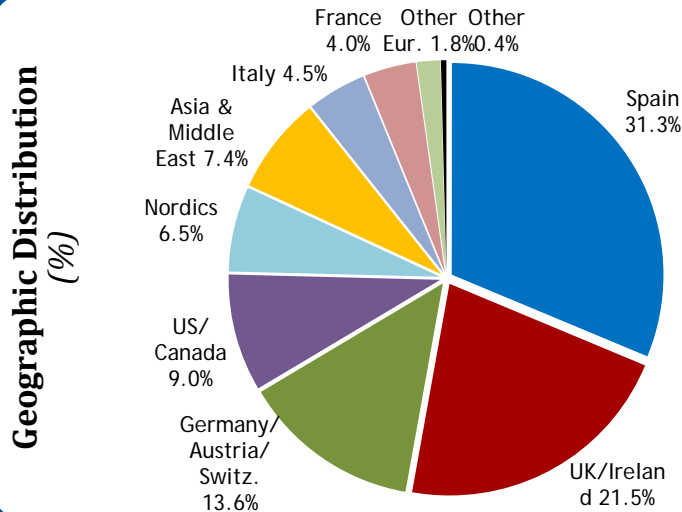
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- ▶ The Treasury will cover most of the funding needs of Regions and Local Governments
- ▶ The bulk of the funding programme to be executed via auctions of Letras, Bonos & Obligaciones
  - ❑ As a novelty, in the first auction of each month the Treasury 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

- ▶ On January 20<sup>th</sup> 2015, the Spanish Treasury launched a 10-year bond (1.60%, April 2025)
- ▶ The orderbook saw demand in excess of €22.8 bn from over 350 accounts. In response to its focus on quality of distribution the final amount issued was €9 bn
- ▶ Pricing was set at mid-swaps+92bps, equivalent to a reoffer yield of 1.656%
- ▶ The issue saw strong international participation (69%), with good interest from Asia and Middles East who accounted for 7.4% of the orderbook. The US represented 9% of the transaction, whilst there was also granular distribution across Europe

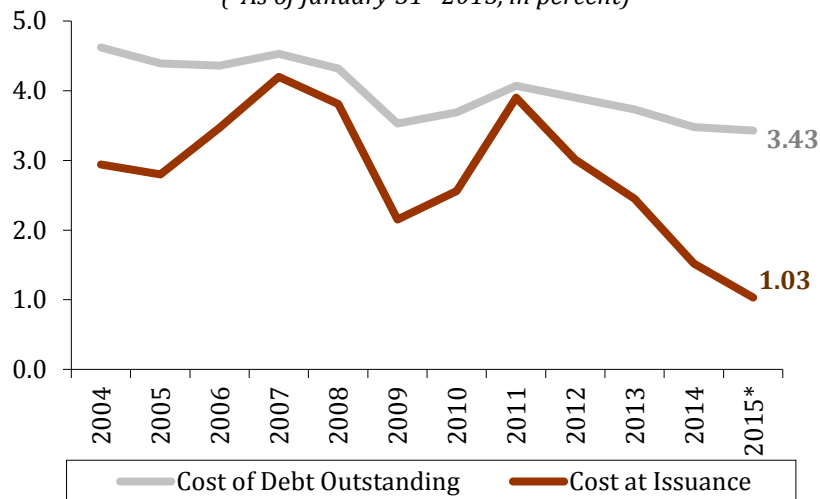
JANUARY - NEW 10 YEAR REFERENCE. APRIL 2025



# Cost and life of debt

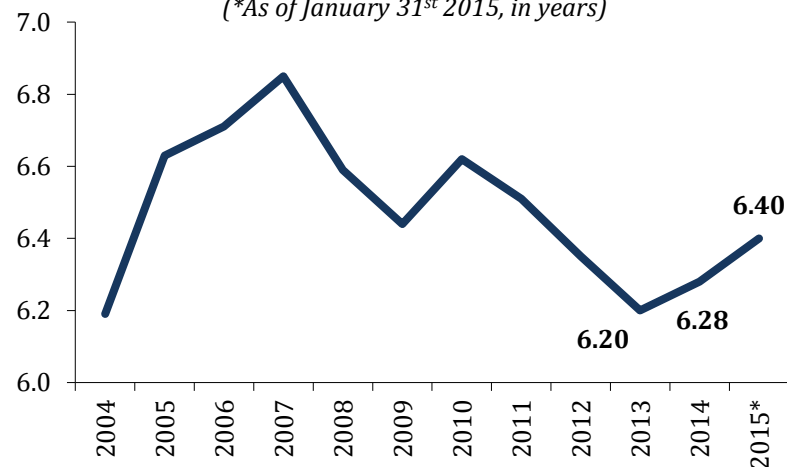
### Cost of Debt Outstanding and Cost at Issuance

(\*As of January 31<sup>st</sup> 2015, in percent)



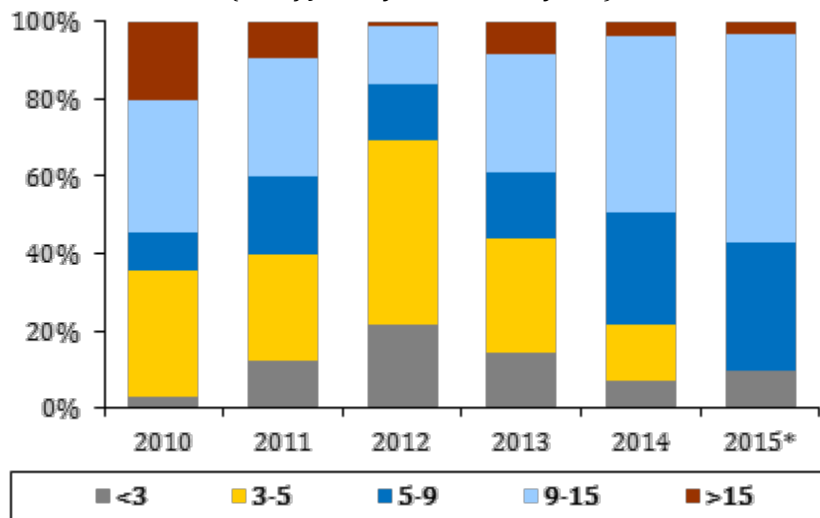
### Average Life of Debt Outstanding

(\*As of January 31<sup>st</sup> 2015, in years)



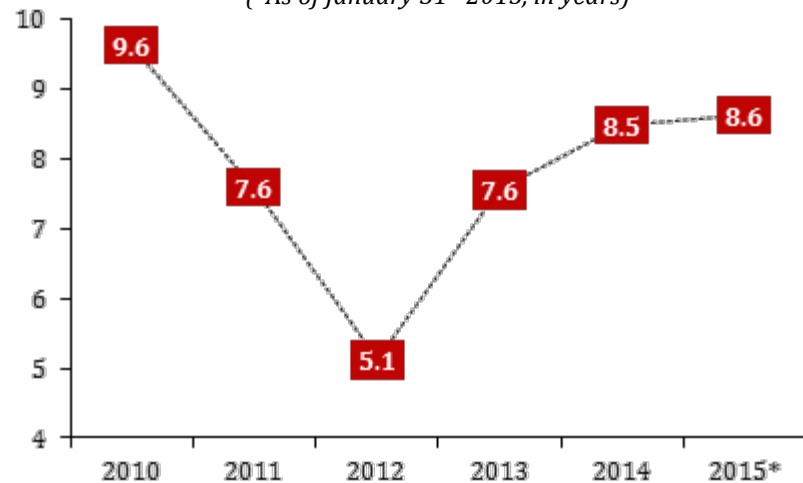
### Marginal Life at Issuance of Bonos and Obligaciones

(\*As of January 31<sup>st</sup> 2015, in years)



### Average Life at Issuance of Bonos and Obligaciones

(\*As of January 31<sup>st</sup> 2015, in years)

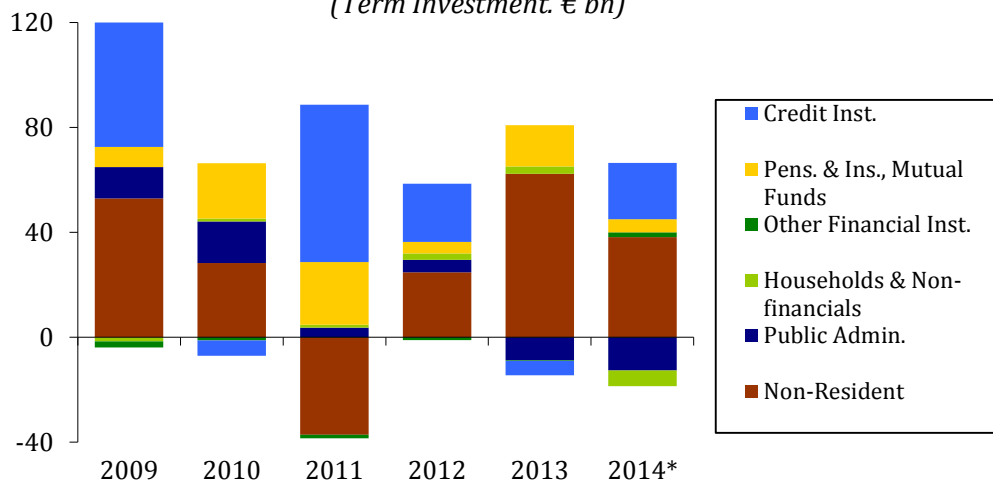


Source: Secretaría General del Tesoro y Política Financiera.

[Data](#)

# Recent trends in investor base

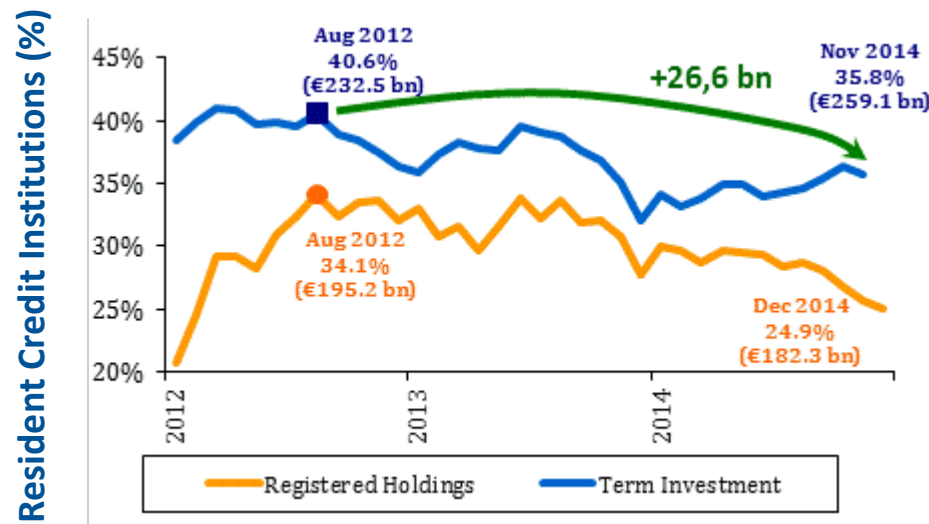
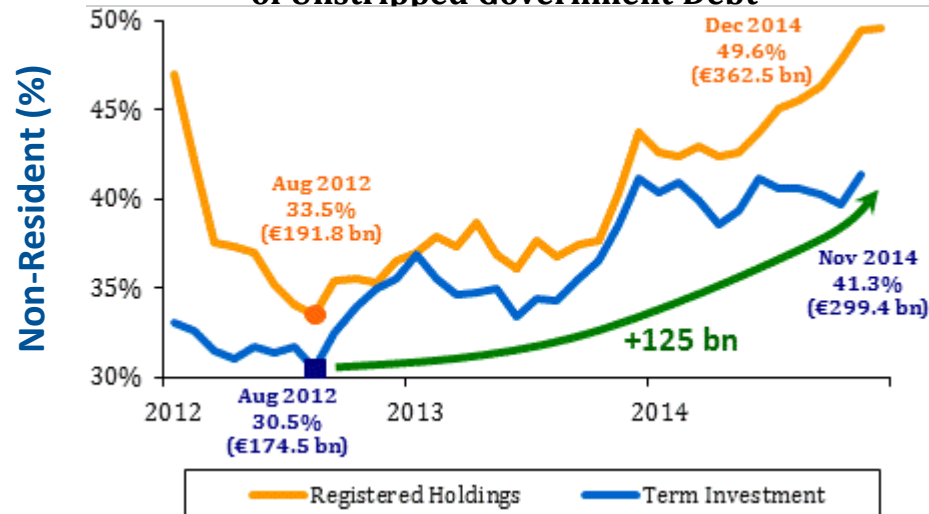
**Change in Term Investment by Investor Type**  
(Term Investment. € bn)



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

[Data](#)

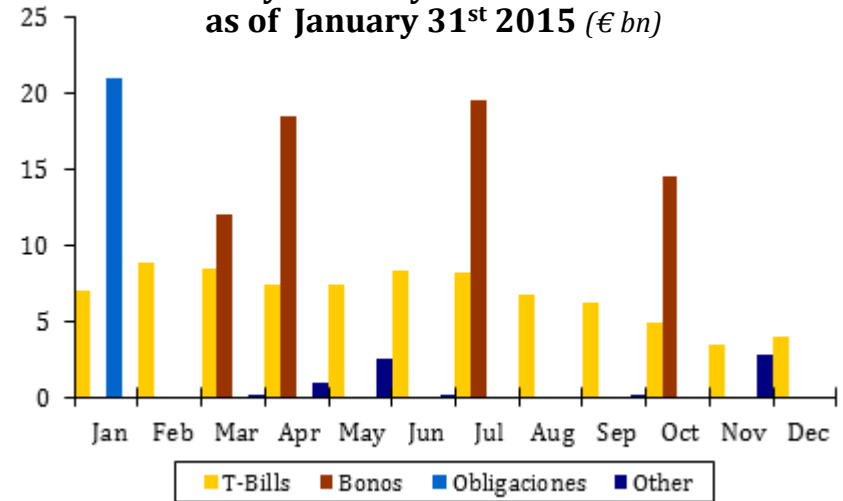
**Holdings of Unstripped Government Debt**



# Prudent debt management

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

Monthly Maturity Structure in 2014 as of January 31<sup>st</sup> 2015 (€ bn)

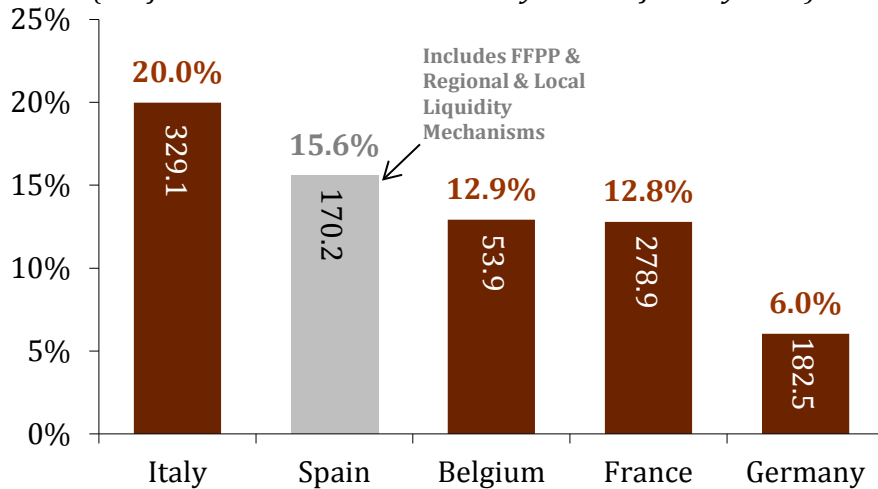


Source: Secretaría General del Tesoro y Política Financiera.

[Data](#)

## Relative Redemptions of Central Governments

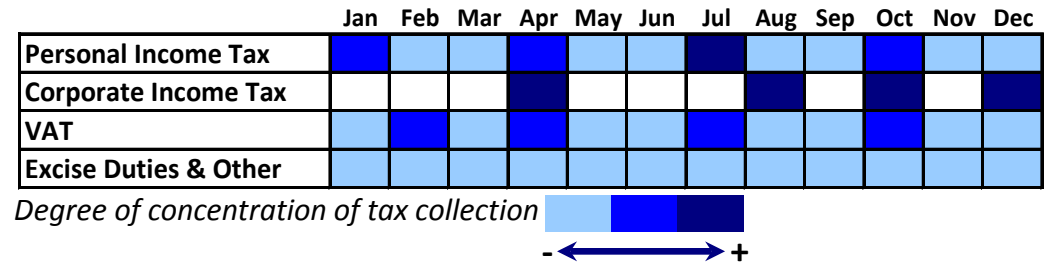
(% of estimated 2015 GDP. February 2014 to January 2015)



Sources: Secretaría General del Tesoro y Política Financiera for Spain, December 31<sup>st</sup> data for Italy, and Bloomberg for other countries.

[Data](#)

## Administrative Distribution of Tax Collection

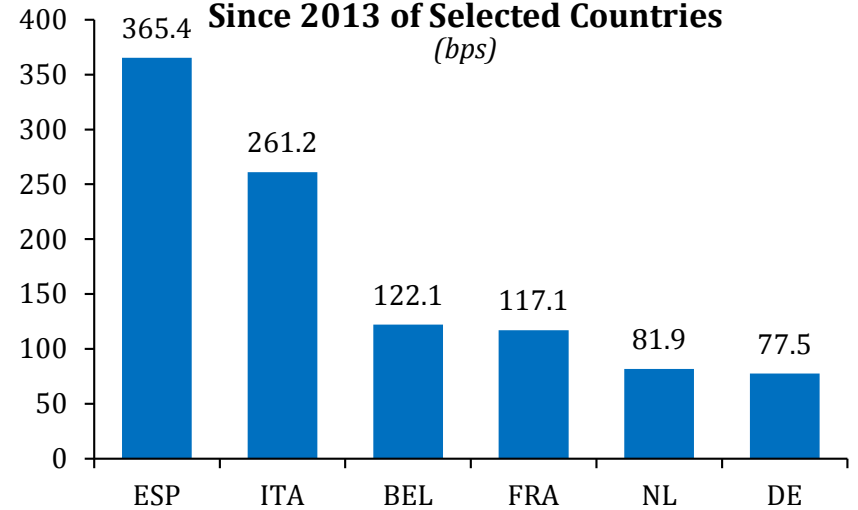




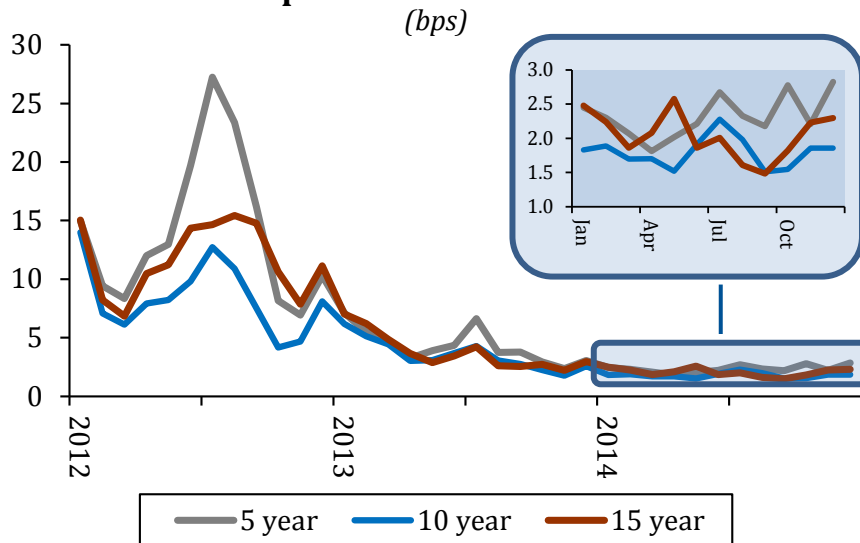
# A more liquid debt market despite spread tightening

- ▶ 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

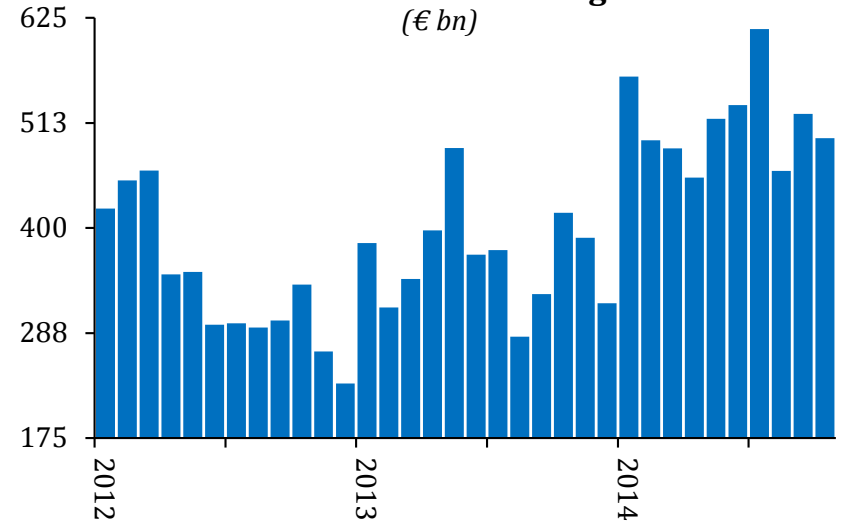
**Reduction in Yield Level of 10 Year Government Bonds Since 2013 of Selected Countries**  
(bps)



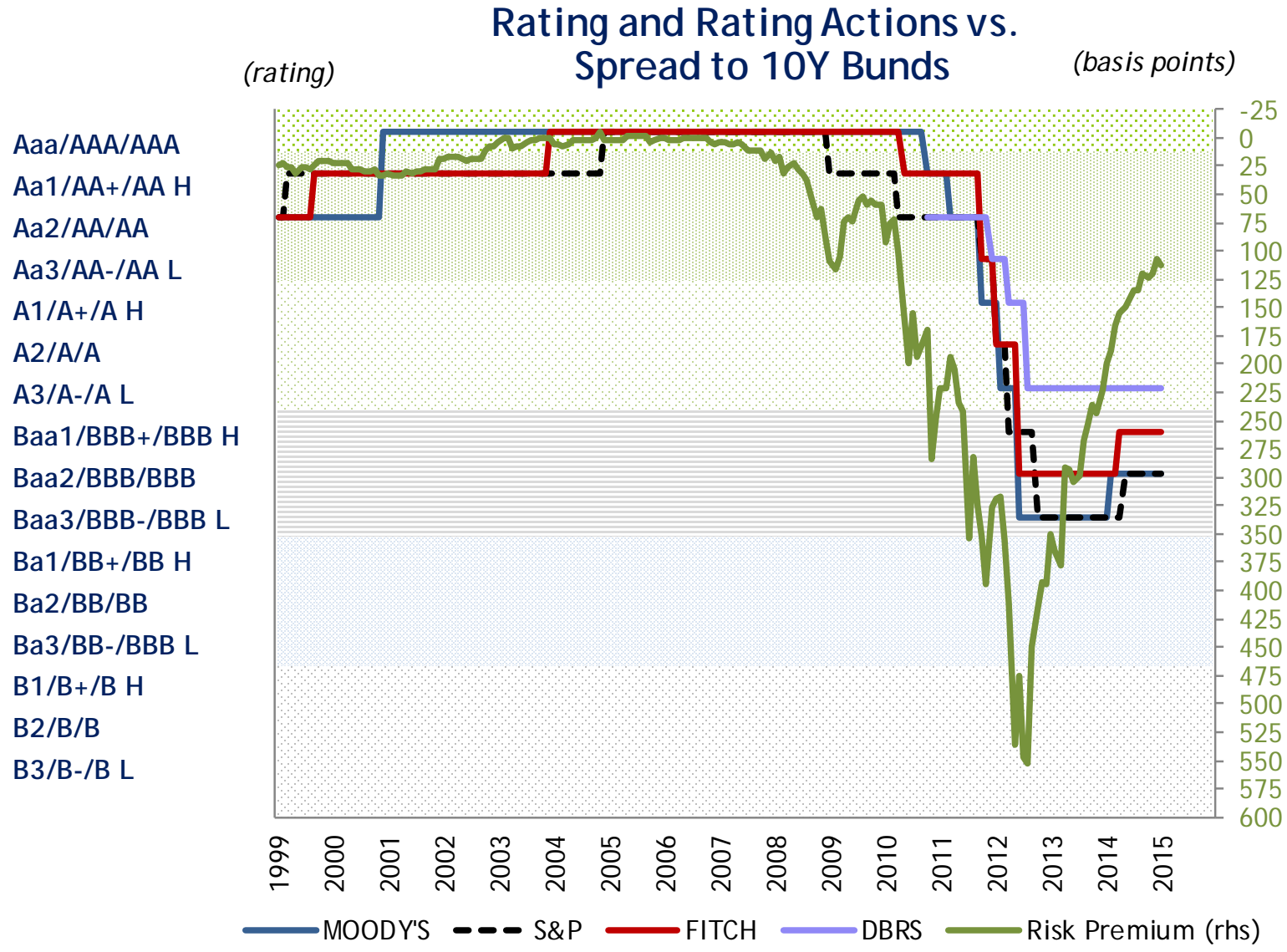
**Bid-Ask Spreads of Government Bonds**  
(bps)



**Turnover of Bonos and Obligaciones**  
(€ bn)



# Evolution of Ratings



*Data*

## More and updated information on the Spanish economy

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For spreadsheets click on 'Data'

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## Thank you for your attention

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