

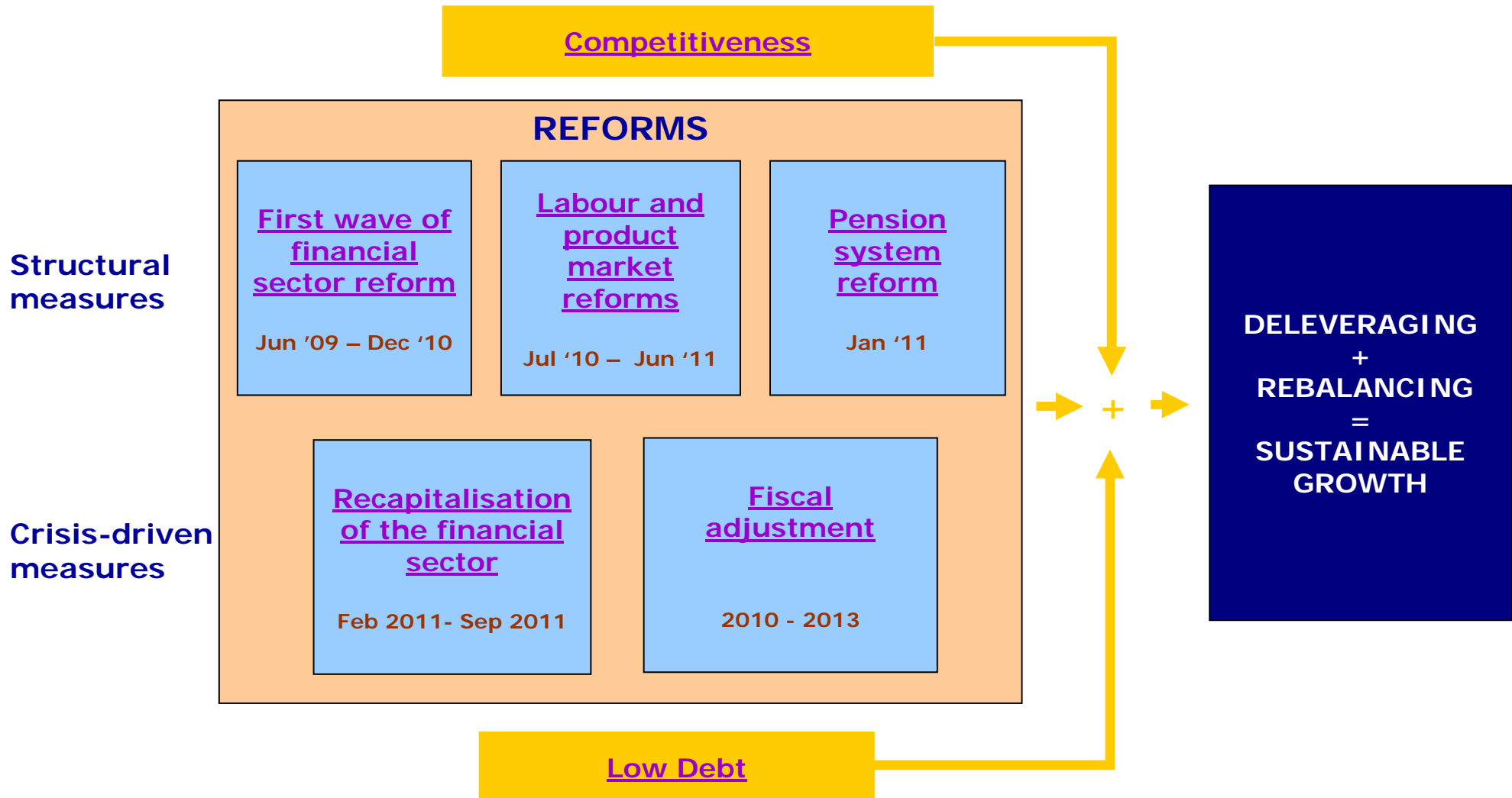


***Spain: Policy measures towards a  
sustained and balanced growth path***

August 2011



## Strengths and reforms are paying off



## Highlights

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The reforms and macroeconomic developments in 2010 and 2011 are laying the foundations of a sound and rebalanced growth for the Spanish economy

Two main questions:

- Are reforms tackling the underlying problems? Existing evidence on financial system reform, labour market reform, business environment & fiscal consolidation says so

Nevertheless, new commitments under “Pact for the Euro Plus” demonstrate the absence of reform fatigue and willingness to further underpin fiscal sustainability, competitiveness and labour market reforms to foster growth

- Can Spain grow? Spanish firms are diversified and competitive and have the potential to absorb resources and to enhance growth in the future



- **Reform strategy**
- **Fiscal consolidation**
- **Future balanced growth path**
- **Funding and Debt Management**

## **No reform fatigue: Pact for the Euro Plus already underway**

- In the framework of the Pact for the Euro Plus Spain has recently committed further actions:
  - To boost competitiveness
  - To boost employment
  - To further underpin the sustainability of public finances
  - To strengthen financial stability
  
- In order to attain these goals Spain is implementing:
  - Budgetary Stability: a new expenditure rule linked to GDP growth
  - Collective bargaining: will soon translate into a draft bill from the Government
  - Creation of an Advisory Committee on Competitiveness
  - Reform of bankruptcy proceedings
  - Impulse to vocational training
  - Plan to reduce irregular employment
  - Strengthened capitalisation requirements for the banking system

## Banking system restructuring

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- Creation of FROB to liquidate non-viable entities and to support restructuring process of viable ones (up to 36 billion with possibility of increasing up to 99 billion if needed). Conditional on cost cutting measures: 25% of branch closure and 15 to 18% of employment reduction
- Regulatory reform of saving banks
- Stress tests & transparency: additional coverage and severity on European Stress Tests (July 2010 and July 2011) coupled with enhanced transparency on asset exposure (since January 2011)
- Saving banks restructuring process: saving banks have decreased in number from 45 to 18
- Law to Strengthen Capital Base and Confidence introduced in February 2011

## Cajas decreased in number from 45 to 18...

Restructuring process of Cajas. Data as of December 2010

Financial institution	Total assets (€ bn)	% of Financial sector RWA	% of Savings Banks' assets	Financial support (€ mn)	Supporting Fund	Institutional setting
BANKIA	328	11.1%	25.2%	4,465	FROB	IPS
LA CAIXA	286	8.1%	22.0%	0	Not requiring	Merger
CATALUNYACAIXA	77	2.6%	5.9%	1,250	FROB	Merger
NOVACAIXAGALICIA	73	2.9%	5.6%	1,162	FROB	Merger
BANCA CIVICA	71	2.5%	5.5%	977	FROB	IPS
MARE NOSTRUM	70	2.3%	5.4%	915	FROB	IPS
CAJA ESPAÑA DE INVERSIONES	46	1.4%	3.5%	525	FROB	Merger
UNICAJA	34	1.1%	2.6%	0	Not requiring	Merger
UNIMM	28	1.0%	2.2%	380	FROB	Merger
CAJA 3	21	0.7%	1.6%	0	Not requiring	IPS
BBK	45	1.6%	3.5%	392	FROB	Business transfer of Caja Sur
<b>TOTAL</b>	<b>1,080</b>	<b>35.3%</b>	<b>83.0%</b>	<b>10,066</b>		

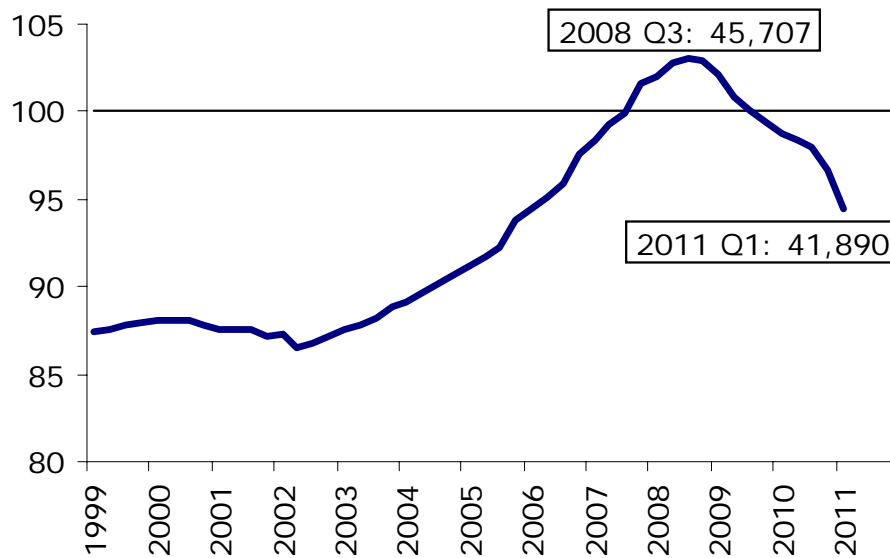
Source: [Bank of Spain](#) and [FROB](#).

\* Additional €3,775 mn from DGS.

## ...followed by a brisk adjustment in capacity

- The strong building up of capacity has been followed by a brisk adjustment, especially during the first months of 2011
- Branch closure since the peak to 2011-Q1: 8.4% and has accelerated in 2011
- Total employment in the financial sector, excluding pension and insurance firms, has decreased by 6% since July 2009 and -8% since the peak in 2008

**Number of Branches**  
*(Index 2009-Q3=100)*



Source: [Bank of Spain](#).

**Number of Employees in the financial sector, excl. pension and insurance**  
*(Index Jul 2009=100)*



Source: [Ministerio de Trabajo e Inmigración](#).

## Market doubts require additional disclosure

- Additional transparency requirements by the Bank of Spain: Cajas have presented specific information on land, construction, residential real estate and residential mortgage portfolios, in particular those related to the guarantees supporting loan-to-value and on the coverage to meet possible impairments
- Published on an individual basis by each financial institution and accessible at the CNMV's web-site

	Exposure (€ bn)	% of exposure
<b>1. Credit risk (=2+3+4)</b>	<b>173</b>	<b>80%</b>
<b>2. Subtotal RRE</b>	<b>117</b>	<b>54%</b>
<i>Completed development</i>	50	23%
<i>Development in progress</i>	26	12%
<i>Urban and developable land</i>	22	10%
<i>Other</i>	19	9%
<b>3. Standard loans under surveillance</b>	<b>28</b>	<b>13%</b>
<i>Completed development</i>	7	3%
<i>Development in progress</i>	4	2%
<i>Urban and developable land</i>	10	5%
<i>Other</i>	7	3%
<b>4. Doubtful loans</b>	<b>28</b>	<b>13%</b>
<i>Completed development</i>	9	4%
<i>Development in progress</i>	5	2%
<i>Urban and developable land</i>	7	3%
<i>Other</i>	7	3%
<b>5. Foreclosed real estate</b>	<b>44</b>	<b>20%</b>
<b>6. Under surveillance, doubtful or foreclosed (=3+4+5)</b>	<b>100</b>	<b>46%</b>
<b>7. TOTAL EXPOSURE (=2+6)</b>	<b>217</b>	<b>100%</b>

Source: [Bank of Spain](#).

## Law to Strengthen Financial Sector (I)

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- The reform aims to restore the credibility of the Spanish financial system and to eliminate any doubts about its solvency cast by the prolonged effects of the crisis and the deterioration of real estate assets.
- Main elements:
  - Increased capital requirements
  - Reform of the FROB
- A few points need to be emphasised:
  - The Government's confidence in the solvency of Spanish financial sector is strong; this plan intends to eliminate any doubts that may linger in the market
  - Recapitalisation to take place in the market; FROB is ready to intervene as a backstop
  - Minimum capital requirements depend on each institution's liability structure
  - Fiscal changes introduced to ensure neutrality throughout these changes

## Law to Strengthen Financial Sector (II)

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### New Capital Requirements

- Increased Capital Requirements
  - General minimum: 8% of RWA
  - An increased minimum of 10% for those that:
    - Depend on wholesale funding (> 20%); and
    - Have not sold enough equity to third parties (< 20%)
  - Possibility to increase this minimum further if additional needs arise as a result of the new stress tests
- Definition of Capital in line with Basle III (2013)
  - Capital, reserves, issuance premia, minority stakes
  - Instruments underwritten by FROB; temporarily, instruments convertible into common equity before December 31<sup>st</sup> 2014
  - Reductions due to losses, positive/negative adjustments based on different valuations, as well as intangible assets

## Law to Strengthen Financial Sector (III)

- February 2011: solvency requirements were increased to 8% or 10%
- March 2011: the Bank of Spain identified capital requirements to reach these new thresholds in 13 institutions which amounted to around €17 billion.
- July 2011: four banks and two savings banks had already met their capital needs (around €5b) through private funds. In addition one saving bank has done so through public funds (around €3b).
  - Three savings banks already listed (50% savings banks' assets)
- September 30th: deadline for implementation
  - If delays are foreseen, these must be communicated 20 days in advance
  - Bank of Spain may authorise, and must explain, a 3-month extension
  - Exceptionally, stock market flotation can be delayed until 2012-Q1

	Capital	Capital ratio required	Capital needs (€ mn)	Recapitalisation alternative
Bankinter	2,144	8.0	333	Instruments qualified as capital
Bankpyme	24	8.0	8	Undetaken to increase of capital
Barclays Bank, S.A.	1,005	8.0	552	Parent company
Deutsche Bank, S.A.E.	729	8.0	182	Parent company
Bankia	14,125	10.0--->8.0	5,775--->1,795	Stock market listing, July 2011
Banca Cívica	3,687	10.0--->8.0	847--->0	Stock market listing, July 2011
Caja España Inversiones	2,062	10.0	463	Integration with another institution
Catalunya-Caixa	3,148	10.0	1,718	FROB
Grupo BMN	3,343	10.0	637	Private investors
Novacaixagalicia	2,851	10.0	2,622	FROB
Unimm	1,150	10.0	568	FROB
CAM*		10.0	2,800	FROB
Effibank*		10.0	519	Various capitalisation alternatives

Source: [Bank of Spain](#).

## Law to Strengthen Financial Sector (IV)

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### Reform of the FROB

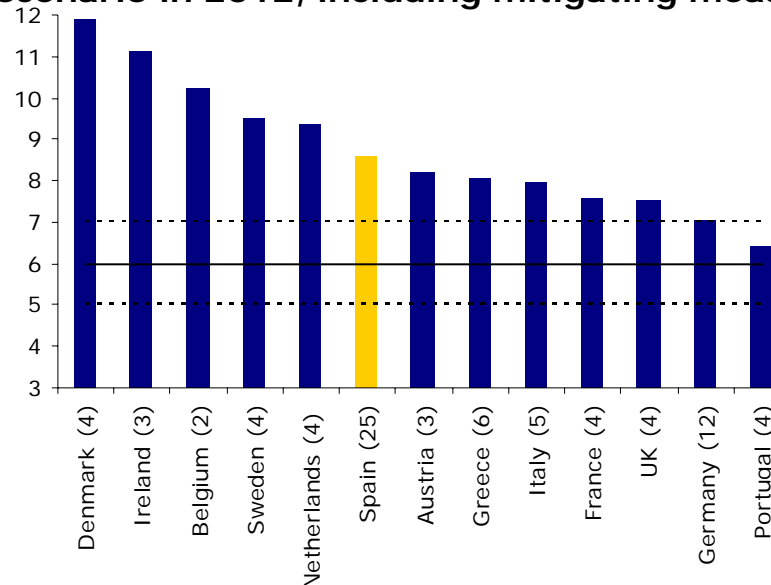
- Objective: to facilitate institutions' capitalisation through FROB as a last resort, when a market recapitalisation is not possible
- FROB financial support (compatible with EU norms):
  - Purchase of ordinary bank shares at market value; beneficiary Cajas must transfer financial activities to a bank in a period of 3 months
  - Disinvestment in 5 years at the latest; early exit agreement at 1 or 2 years from entry
  - Recapitalisation plan to include commitment to reduce structural costs, improvement in corporate governance, with a view to facilitate the flow of credit
- Change in the composition of FROB's Governing Committee: 9 members
  - 2 from Ministry of Economy and Finance
  - 4 from Bank of Spain
  - 3 from Deposit Guarantee Funds



## EBA stress tests. Main outcomes

- 25 Spanish banks subject to the tests (28% of the sample), representing 93% of the Spanish financial sector assets
- Only 5 Spanish banks fail to meet the core tier 1 capital ratio threshold of 5% in the adverse scenario without mitigating instruments
- Once considering key mitigating instruments, generic provisions and convertible debt all Spanish financial institutions pass the threshold
- Law to Strengthen Financial Sector (RDL 2/2011) frontloaded the effects of the stress tests

**Average weighted CT1 capital ratios under adverse scenario in 2012, including mitigating measures**



Source: [European Banking Authority](#).



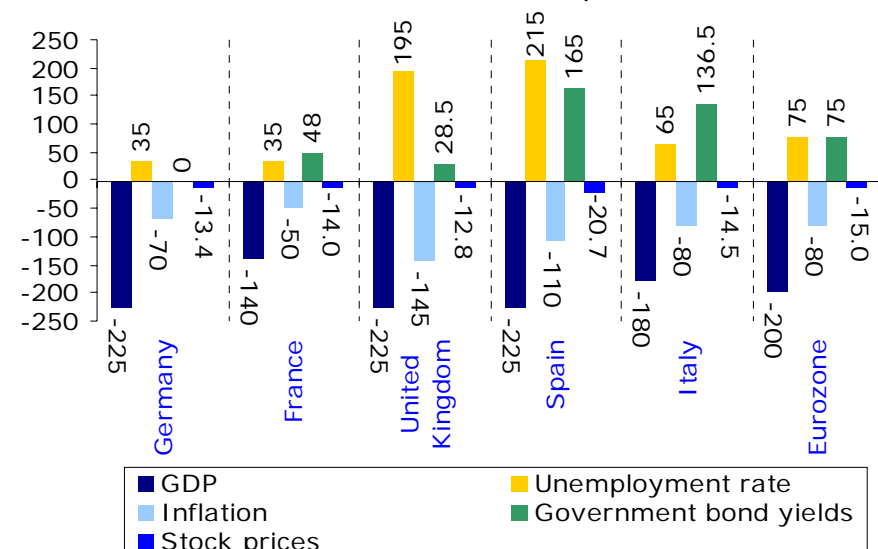
## EBA stress tests: harsh assumptions...

- GDP cumulative decline of 2.1%, 4.6 points below the European Commission's central scenario. The probability of occurrence of this scenario is negligible, below 0.5%
- Adjustments to sovereign debt in the Banking Book following a loss provisioning approach; severe adjustments in trading book according to reduction in the market value of bonds derived from the wider sovereign spreads
- The assumptions of the stressed scenario envisage that from the peak observed in the period to 2012, housing prices in Spain would fall by 34% in real terms and land by 63%

Adverse Scenario: some Assumptions 2011-2012	
	<b>Spain</b>
% Banking Sector Assets	93.0%
GDP (Cummulative % decrease)	2.1%
Probability of occurrence	< 0,5% (2011 and 2012)
<b>NOI (% change from benchmark to stressed scenario)</b>	
Overall system	-7.2%
Savings Banks	-27.1%
<b>Cumulative decrease in real estate prices (2011-2012)</b>	
House prices	21.9%
Commercial Real Estate	46.7%

Source: [Bank of Spain](#).

Average deviation from baseline to stressed scenario  
(2011-2012, in basis points)

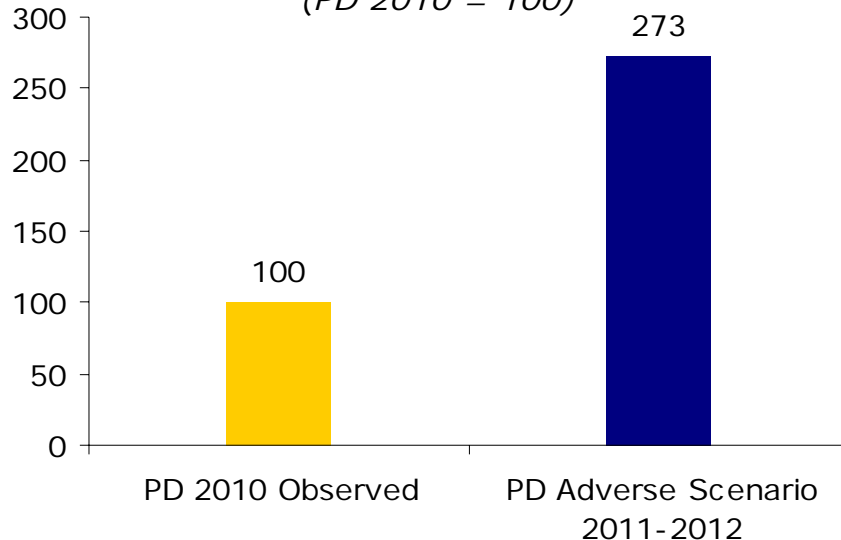


Source: [European Banking Authority](#).

## ... give rise to large hypothetical impairments

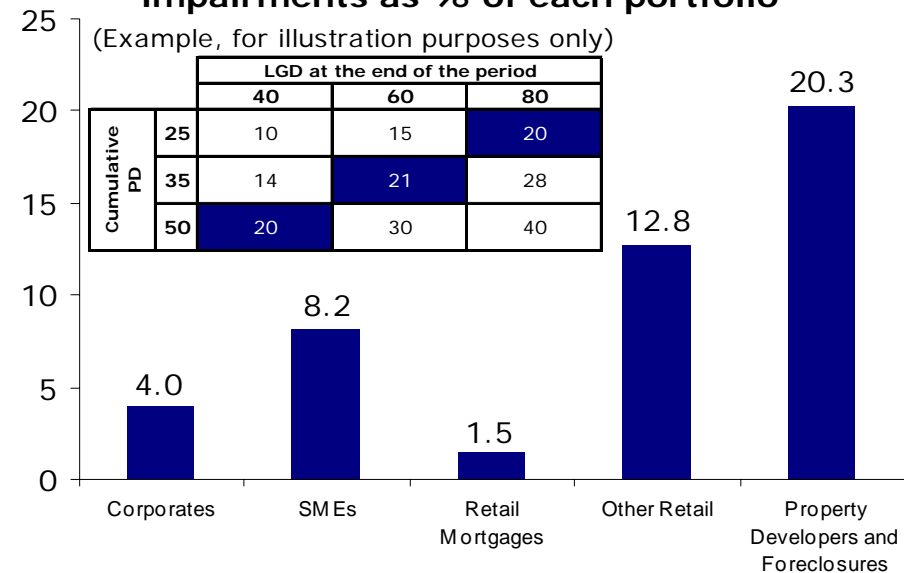
- Impairments under severe scenario concentrated in other retail, SMEs as well as in property developers and foreclosures
- The adverse macroeconomic scenario gives rise to a pronounced increase in the ratio of observed vs stressed PDs of Cajas
- Net operating income under severe stress with a 19% average decrease over 2011 and 2012

**Index of observed and stressed PD of Savings Banks Total Credit Portfolio**  
(PD 2010 = 100)



Source: [Bank of Spain](#).

**Total system. Adverse Scenario. Hypothetical impairments as % of each portfolio**

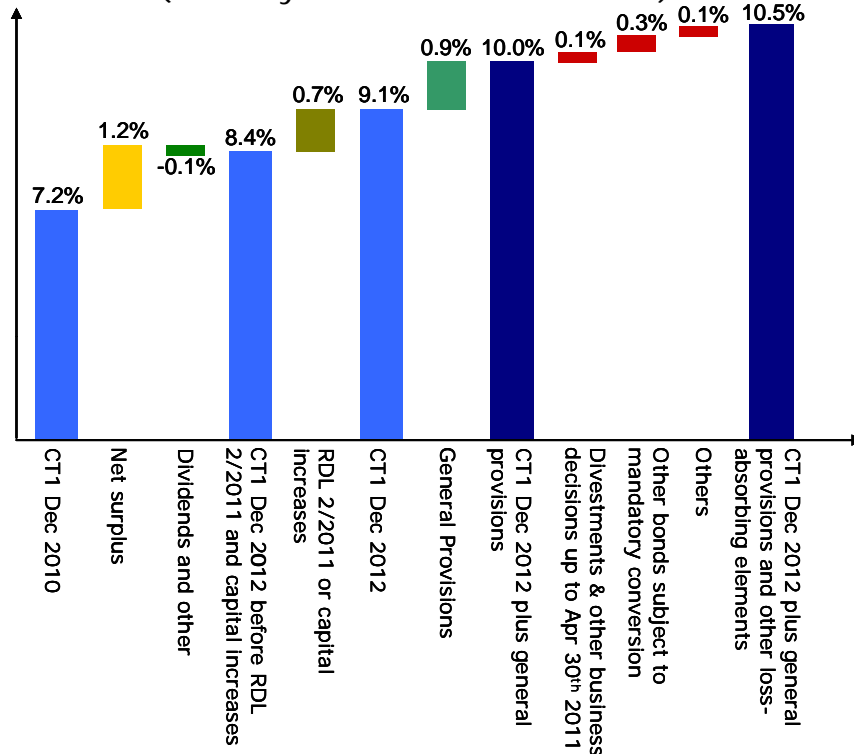


Source: [Bank of Spain](#).

## EBA stress tests results

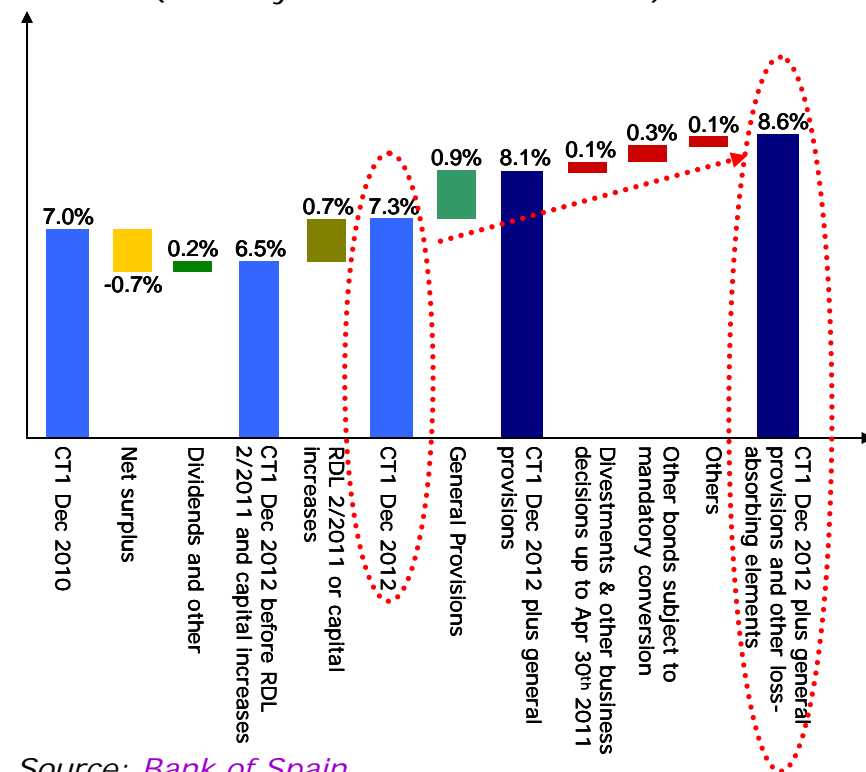
- On an aggregate basis the stressed scenario's CT1 as of Dec 2012 reaches 7.3%.
- If general provisions (€17.6 bn) and other loss-absorbing elements (€9.2 bn) are included, Core Tier 1 rises to 8.6%

**Core Tier 1 baseline scenario**  
(Total system. % of 2012 RWA)



Source: [Bank of Spain](#).

**Core Tier 1 stressed scenario**  
(Total system. % of 2012 RWA)



Source: [Bank of Spain](#).

## Labour market reform (I)

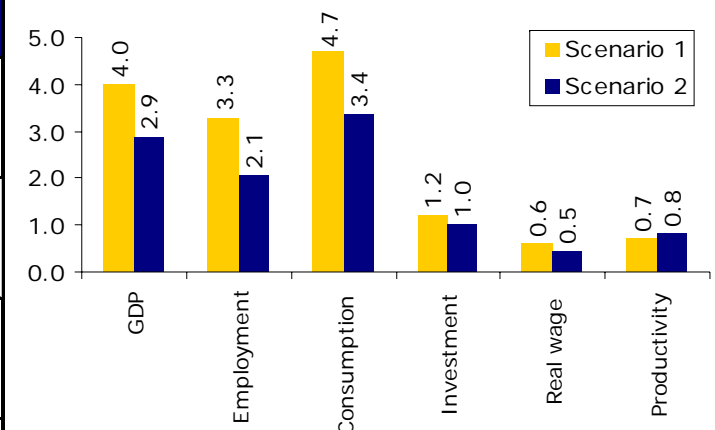
• The reform seeks to correct the dual nature of Spain's labour market and the low internal flexibility at firm level which has led firms to adjust to the cycle via a quick creation/destruction of jobs

**Approved 19/09/2010**

- Foster permanent and training contracts
- Promotion of "Contrato de Fomento": with lower severance costs in case of economic grounds (improving definition of causes for dismissal)
- Increase the internal flexibility at firm level: firms can opt out from conditions imposed by sector-specific collective bargaining agreements

Main outlines of the Labour Market Reform				
OBJECTIVES				
MEASURES	Close relationship between working conditions and the specific situation of each firm	Reducing segmentation	Improve matching in the labour market	Enhancing human capital
	Effective opt-out from collective bargaining	Generalised "contrato de fomento"	Temporary Agency Work Directive	Eligibility for training contracts extended
	Short-time working arrangements that favour reduction of hours	Higher severance payments for temporary contracts since 2012	Private for-profit employment Agencies	Social Security rebates to unemployed
		Clarification of reasons for objective dismissals		
		Capitalisation Fund		

**10-year effect of the Labour Market Reform**  
(In percent change from baseline scenario)



## Labour market reform (II)

Approved 11/02/2011

- Active labour market policies have been improved:
  - Incentives for hiring young people on a part-time basis through reductions in social security contributions
  - Individualised guidance itineraries for young unemployed, older long-term unemployed and unemployed from the construction industry
  - The number of professional counsellors doubled to facilitate mediation
  - Introduction of an unemployment assistance grant conditional upon training courses once unemployment benefit has run out
  - Creation of private employment agencies
- On-going actions
  - 30,000 internship grants for young people through agreements with large corporations
  - Reform of the part-time employment contract
  - Creation of an annual employment strategy with targets and available resources

## Labour market reform (III)

Approved 22/06/2011

### Collective Bargaining Reform

- Simplification and increased coordination of the bargaining process
  - Prevalence of collective bargaining at the provincial level
  - Creation of a Labour Relations and Collective Bargaining Council
- Collective bargaining at the company level is incentivised
  - Priority over sector-specific agreements in matters related to wage levels and structure, the distribution of working hours and the adaptation at the company level to the professional classification
- Facilitation of adaptation of agreements to changing economic conditions via
  - Adaptation to changing economic conditions
  - Renegotiation after expiry of agreements is encouraged
  - Compulsory arbitration in case of disputes
- Introduction of further instruments for internal flexibility
  - Opting out possible if an agreement reduces the competitive position of firms or continuous fall in a firm's revenues
  - Specification of percentage of hours to be distributed irregularly throughout the year (a minimum of 5%) and functional mobility within the companies

## Pension reform to guarantee fiscal sustainability

Main guidelines of the Pension System reform:

Approved 21/07/2011

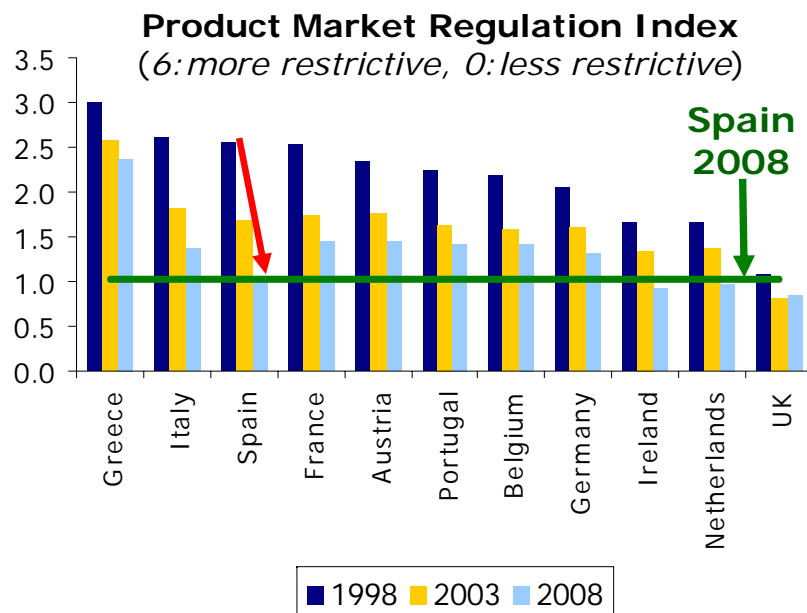
- Gradual increase in the statutory retirement age from 65 to 67 (retirement with 65 years is only allowed for long-contributing careers)
- Tightening for the conditions for eligibility for early retirement; partial retirement made more expensive
- Reinforcing the relationship between contributions and benefits:
  - The pension is computed as a function of the last 25 years of career (increased from 15 years)
  - Increase in the number of years worked (at least 37 years) for full pension entitlement
- Sustainability factor: adjustment of the relevant parameters of the current system to the changes in life expectancy every 5 years from 2027 onwards

Impact of the reform of the Social Security system (% GDP)						
	Higher potential GDP	Increase in statutory retirement age	Increase in years for calculating pension	Increase in years needed for full pension	Sustainability factor	TOTAL IMPACT
2030	0.1	0.8	0.4	0.1	0.0	<b>1.4</b>
2040	0.2	1.0	0.8	0.3	0.5	<b>2.8</b>
2050	0.2	1.0	1.0	0.3	1.0	<b>3.5</b>

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

## Product market reforms

- According to the OECD, Spain has pursued a substantial reduction of product market regulation and bureaucracy in the last decade
- Spain is currently well placed against other OECD countries, but...
- ...still some elements of market rigidities remain in the economy and are being addressed
- Broad agreement on Industrial Policy, Energy Policy and R&D+Innovation Policy on February 3<sup>rd</sup> 2011



Approved 03/12/10 and 07/07/11

Liberalisation measures	
<b>SMEs</b>	Business angels, exemption on capital gains for entrepreneurial projects ----- Reduction of the corporate tax rate for SMEs, 20%-25% ----- Payments to suppliers by municipalities have been facilitated
<b>Enterprise incorporation</b>	Maximum time limit of five days for more than 80% of companies
<b>Bankruptcy Law</b>	Facilitates the viability of companies undergoing difficulties through agreements with creditors
<b>Free amortisation tax scheme</b>	Extended for new investments

## Privatisation measures underway

Airports	Lotteries	Telecommunications
<ul style="list-style-type: none"> <li>● Separation of airport operation and air traffic control <i>(Completed in Feb. 2011)</i></li> <li>● Major airports concessioned to private operators (Madrid and Barcelona) <div style="border: 2px solid #800000; padding: 2px; display: inline-block; margin-top: 5px;"><i>November 2011</i></div></li> <li>● Privatization up to 49% of the National Airport System <div style="border: 2px solid #800000; padding: 2px; display: inline-block; margin-top: 5px;"><i>1st quarter 2012</i></div></li> </ul> <p style="text-align: center;">Expected revenues: 3,000M€-4,000M€</p> <p style="text-align: center;">Effect on debt</p>	<ul style="list-style-type: none"> <li>● New gambling law:               <ul style="list-style-type: none"> <li>▪ Separation of regulation and operation</li> <li>▪ Regulation of on-line gambling</li> </ul> <i>(Approved, may 2011)</i> </li> <li>● Privatization of 30% of the National Lottery <div style="border: 2px solid #800000; padding: 2px; display: inline-block; margin-top: 5px;"><i>November 2011</i></div></li> </ul> <p style="text-align: center;">Expected revenues: 7,000M€-9,000M€</p> <p style="text-align: center;">Effect on debt</p>	<ul style="list-style-type: none"> <li>● Introduction of technological neutrality in the usage of spectrum</li> <li>● Reallocation of the TDT extra-spectrum to telephone services</li> <li>● Spectrum auction <div style="border: 2px solid #800000; padding: 2px; display: inline-block; margin-top: 5px;"><i>July 2011</i></div></li> </ul> <p style="text-align: center;">Effective revenues: 1,825M€</p> <p style="text-align: center;">Effect on deficit and debt</p>



- **Reform strategy**
- **Fiscal consolidation**
- **Future balanced growth path**
- **Funding and Debt Management**

## Our commitment: achieving a fiscal deficit of 3% in 2013

- More than 60% of total fiscal adjustment delivered in first 2 years
- Deficit targets robust to:
  - Implementation risks, via stronger control mechanisms on all levels of Government
    - Ex-post control: regions require authorisation of debt issuance depending on the compliance of the previous year's target
    - Ex-ante control: three-stage authorisation
  - Negative growth surprises, as targets are not conditional on macroeconomic performance
  - Deficit objective of 2.1% for 2014

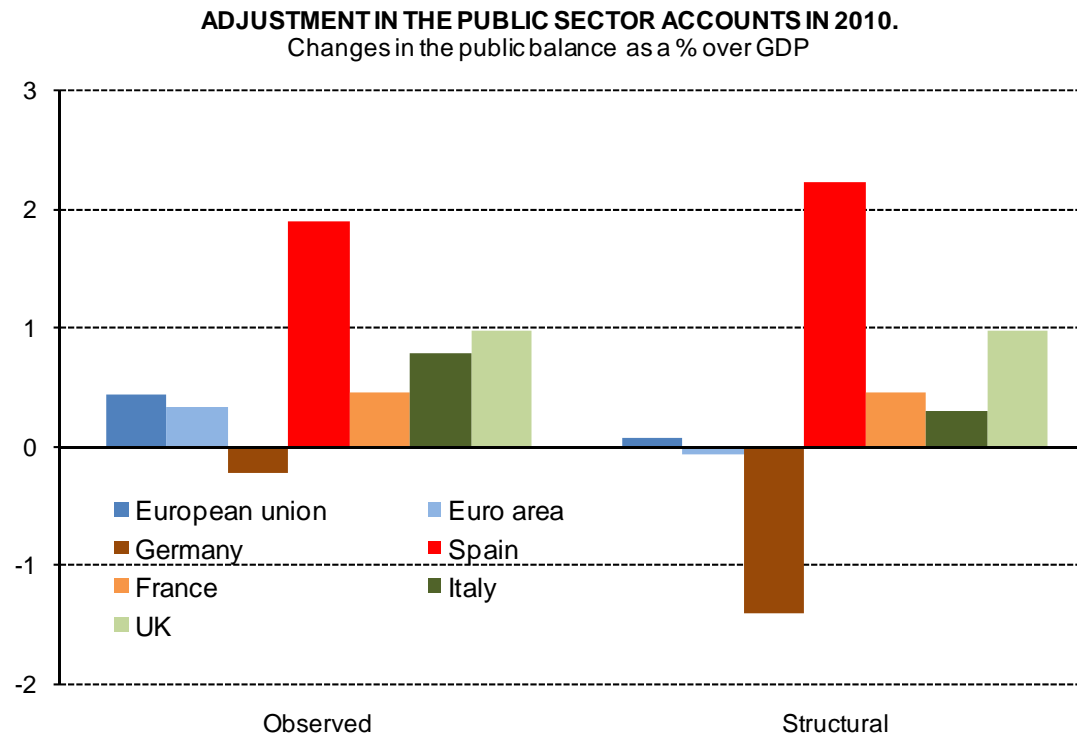
General Government commitments by unit (% of GDP)							
	2009	2010		2011	2012	2013	2014
		Commitment	Execution				
<b>General Government Budget Balance</b>	<b>-11.1</b>	<b>-9.3</b>	<b>-9.2</b>	<b>-6.0</b>	<b>-4.4</b>	<b>-3.0</b>	<b>-2.1</b>
- Central Government	-9.3	-5.9 (-6.7)	-5.0 (-5.7)	-2.3 (-4.8)	-3.2	-2.1	-1.5
- Autonomous Communities	-2.0	-3.1 (-2.4)	-3.4 (-2.8)	-3.3 (-1.3)	-1.3	-1.1	-1.0
- Local Governments	-0.6	-0.6 (-0.4)	-0.6 (-0.5)	-0.8 (-0.3)	-0.3	-0.2	0.0
- Social Security	0.8	0.2	-0.2	0.4	0.4	0.4	0.4

Source: *Stability Programme Update 2011-2014*.

In brackets: net of internal transfers among Public Administration units.

## And the fiscal consolidation effort is remarkable

- In 2010 Spain has been one of the European countries that reduced the most the public deficit
- Furthermore, that effort was made in a more adverse economic environment



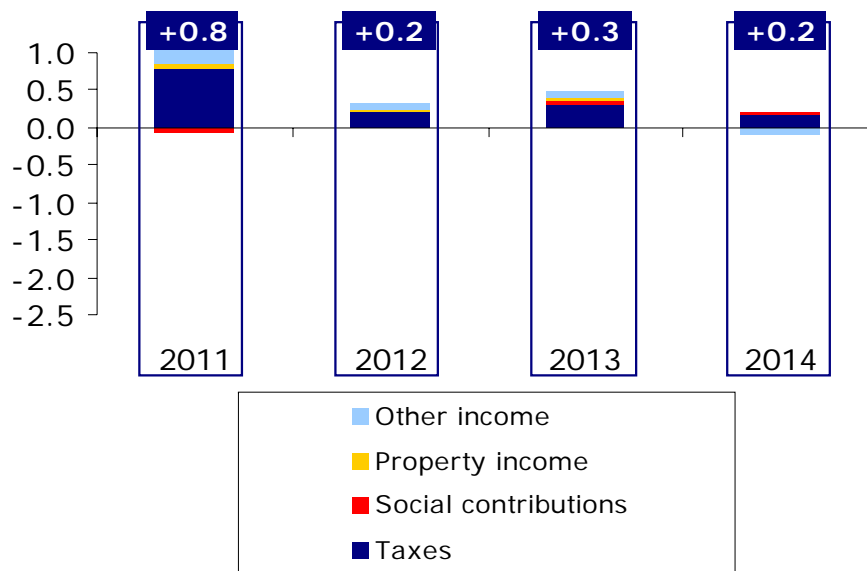
Source: European Commission.

## Fiscal deficit reduction 2011-2014

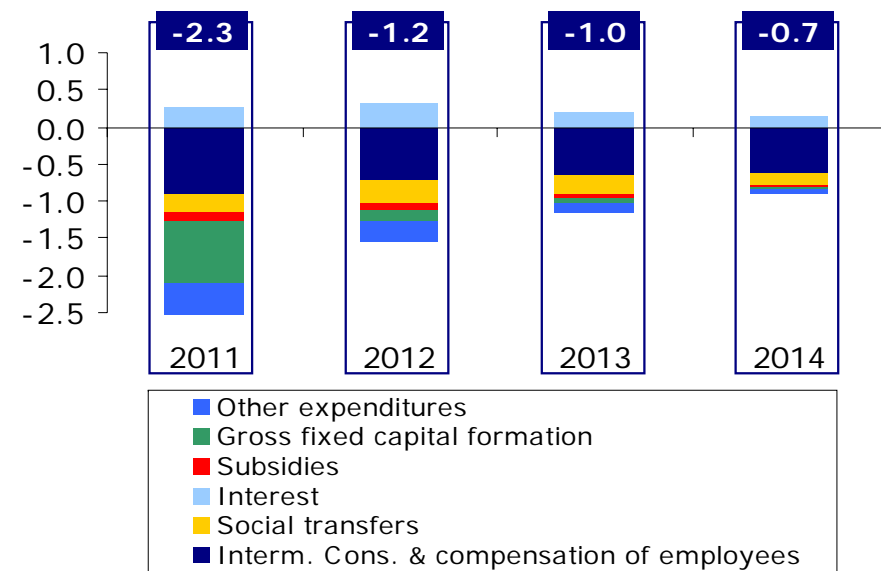
- Most of the adjustment is made via the expenditure side
- 2011: expenditure reduction measures amount to 2.3% of GDP; 0.8% of GDP stemming from the income side
- Expenditure ceiling for the Central Government Budget 2012 sets the maximum expenditure attainable: €117.4 bn, -3.8% with respect to 2011 Budget

Approved on 12/07/2011

Change in General Government income  
(% of GDP, EDP)



Change in General Government expenditure  
(% of GDP, EDP)



Source: [Stability Programme Update 2011-2014](#).

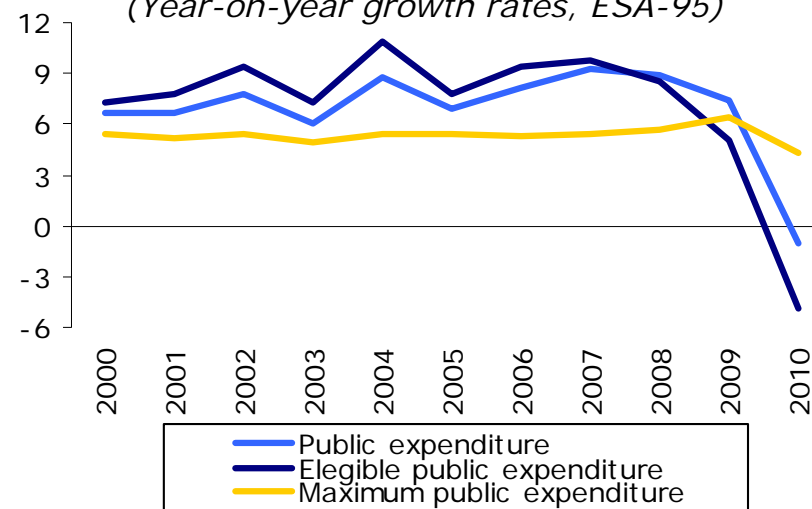
Source: [Stability Programme Update 2011-2014](#).



## Introduction of a new spending rule

- In expansionary periods, the spending rule will limit the maximum growth of public expenditures to the reference growth of the Spanish economy:
- That reference growth will be calculated as the simple average of the last five years annual growth rates of real GDP and the next four, plus an unchanged rate of inflation at 1.75%. Eligible expenditure excludes interest payments and non-discretionary unemployment benefits
- Approved for Central and Local Governments; presented on July 27<sup>th</sup> to the Regions in the Fiscal and Financial Policy Council and to be adopted within a six month time-frame

**Maximum expenditure implied by new rule vs total non-financial expenditures of the Central Government**  
*(Year-on-year growth rates, ESA-95)*

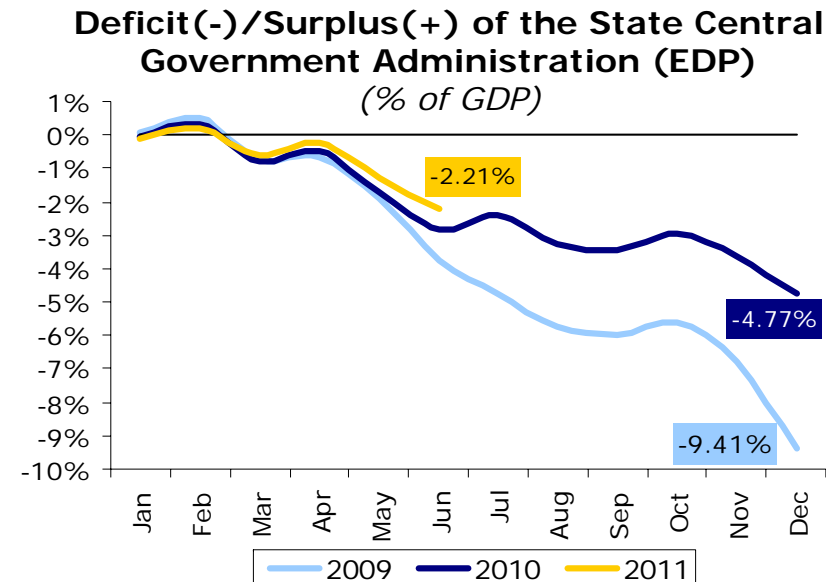


**Approved on**  
**14/07/2011**

Source: Ministerio de Economía y Hacienda.

## Budget execution of the State Central Government Administration

- Cumulative revenues of the State Central Government Administration, net of internal transfers among Public Administration units, register negative growth rates due to increased participation in tax receipts of the regions in the new regional financing system introduced in March 2010 → Overall tax collection has risen by 4.2%, while revenues of the State in EDP terms to end-June amounted to €49.4 billion (-13.0% yoy)
- Expenditures of the State in EDP terms have reached €73.5 billion (-15.0% yoy)
- The cumulative deficit of the State Central Government Administration reached €24.1 billion (-18.9% yoy), compatible with a primary deficit of €13.6 billion (-36.1% yoy)
- In order to assess the degree of compliance it is necessary to take into account that by year-end the settlement of internal transfers to the Regions will take place; following provisional estimates this will imply a reduction by 2.5% of GDP of the State Central Government Administration deficit for 2011 in EDP terms, and an increase by 2.5% of GDP in the overall deficit of Regions and Local Governments



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

## Monitoring Autonomous Communities (I)

- All regions require authorisation of debt issuance depending on the compliance of the previous year's target and the presentation of a rebalancing plan (See table below)
- For the first time, in 2010, the authorisation for new issuance was extended in three stages. In 2011 the authorisation procedure has been agreed upon in the Council for Fiscal and Financial Policy: an initial authorisation of up to 0.65% of regional GDP, followed by an additional 0.40% for regions compliant budgetary execution in the first semester and a final 0.25%, after compliance in the second semester

Requirement of authorisation

Objective of budgetary stability	Euro denominated and foreign currency bond issuance	Long-term operations (>1 year)	Short-term operations (<1 year)
Compliance	Yes	No	No
Non-compliance with rebalancing plan	Yes	Yes	No
Non-compliance without rebalancing plan	Yes	Yes	Yes

Source: [Ministerio de Economía y Hacienda](#)

## Budgetary execution and rebalancing plans of Regions

- Regions compliant with 2009 budget stability targets or presenting a deficit target below 0.75% of regional GDP in 2011 do not need to present a rebalancing plan –applicable to Madrid and La Rioja-
- The rebalancing plans approved on April 27th, in addition of those by the Basque Country and Navarra –with a different fiscal framework— represent a total adjustment of 4.3 billion Euros. Further rebalancing plans have been approved on July 27th

•The first tranche of 2011, equivalent to 0.65% of the GDP of each autonomous region, is not authorised for other regions until the rebalancing plan is approved

• Regions without an approved rebalancing plan must achieve a balanced budget in the period 2012-2014

• Working group for reporting on regional rebalancing plans in September 2011

**Budgetary execution and structure of Comunidades Autónomas for 2010**

	% TOTAL GDP	% Debt to Regional GDP (EDP) (2011-Q1)	Population (% of total)	Deficit* (% of regional GDP)	Rebalancing plan. Jul 2011
Madrid	17.9	7.4	13.8	-0.69	Not required
Extremadura	1.7	9.9	2.3	-2.23	Approved
País Vasco	6.3	7.3	4.6	-2.24	-
Canarias	3.9	7.8	4.5	-2.31	Approved
Galicia	5.2	11	5.9	-2.43	Approved
Castilla y León	5.4	7.7	5.4	-2.56	Approved
Cantabria	1.3	7.9	1.3	-2.59	Approved
Asturias	2.2	7.1	2.3	-2.61	Approved
Andalucía	13.5	8.9	17.9	-2.99	Approved
Aragón	3.1	10.1	2.9	-3.07	Approved
La Rioja	0.7	11.0	0.7	-3.26	Not required
Valencia	9.6	17.4	10.8	-3.47	Approved
Navarra	1.8	10.3	1.3	-3.50	-
Cataluña	18.6	17.2	15.9	-3.86	Under review
Illes Balears	2.5	16.3	2.3	-4.16	Approved
Región de Murcia	2.6	8.5	3.2	-4.95	Approved
Castilla-La Mancha	3.4	16.9	4.4	-6.47	Under review
<b>TOTAL</b>	<b>99.6</b>	<b>11.4</b>	<b>99.7</b>	<b>-2.83</b>	

Source: *Ministerio de Economía y Hacienda, National Statistics Institute and Bank of Spain.*

\* Net of internal transfers among Public Administration units.

## Preliminary budgetary execution of Regions in first Q1-2011

- The Economic and Financial Rebalancing Plans presented are complimentary to the reduction in non-financial expenditure presented in regional budgets
- Quarterly Budgetary execution of the Regions published on a cash basis since 2010-Q3
- In 2011-Q1 the revenues of the regions declined by 2.23%, while expenditures rose by 5.44%
- The overall budgetary cash balance of the regions in Q1 reached -0.46% of GDP
- The budgetary execution of half of the sample shows an evolution consistent with the deficit target for 2011
- The rest of the regions have been requested to accelerate their respective rebalancing plans

	Budgetary deficit(-) /surplus(+) 2011-Q1 (% of regional GDP)
Madrid	-0.60
Extremadura	-0.64
País Vasco	-0.77
Canarias	-0.28
Galicia	0.14
Castilla y León	-0.40
Cantabria	-0.26
Asturias	-0.26
Andalucía	-0.75
Aragón	0.19
La Rioja	0.18
Valencia	-0.67
Navarra	-0.07
Cataluña	-0.09
Illes Balears	-0.97
Región de Murcia	-0.89
Castilla-La Mancha	-0.97
<b>TOTAL</b>	<b>-0.46</b>

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



- **Reform strategy**
- **Fiscal consolidation**
- **Future balanced growth path**
- **Funding and Debt Management**

## Updated macroeconomic scenario 2011-2014

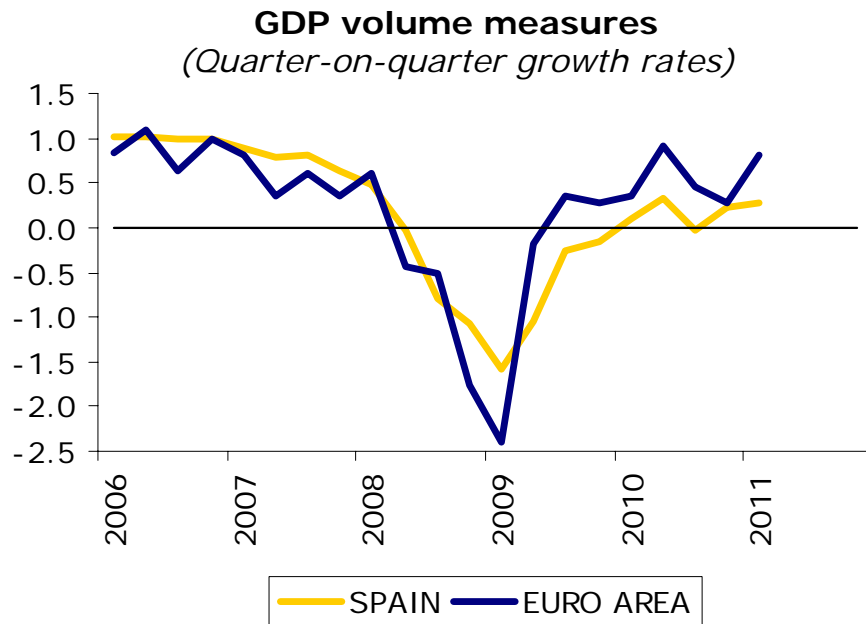
- Growth sustained by the contribution of net external demand, which will boost productive investment. Domestic demand will progressively gain momentum
- Revision: lower growth of domestic demand until 2014, partially compensated by higher external demand, leads to lower net borrowing requirements
- Unemployment rate has been revised upwards due to 2010 outcome and expected lower employment growth in the following years

<b>Macroeconomic scenario 2011-2014</b> <i>(Growth rate in percent)</i>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>
<b>GDP</b>	<b>-0.1</b>	<b>1.3</b>	<b>2.3</b>	<b>2.4</b>	<b>2.6</b>
Final Private Consumption Expenditure	1.2	0.9	1.4	1.6	1.9
Final Public Consumption Expenditure	-0.7	-1.3	-0.8	-0.6	-0.6
Gross Fixed Capital Formation	-7.6	-1.3	2.7	3.7	4.5
Equipment and other products	-2.4	3.2	5.2	5.9	6.6
Construction	-11.1	-4.7	0.7	1.7	2.4
<b>National Demand (contribution to GDP growth)</b>	<b>-1.2</b>	<b>0.0</b>	<b>1.3</b>	<b>1.7</b>	<b>2.0</b>
Exports of Goods and Services	10.3	8.3	7.9	7.2	7.1
Imports of Goods and Services	5.4	3.0	4.1	4.7	5.2
<b>External demand (contribution to GDP growth)</b>	<b>1.1</b>	<b>1.3</b>	<b>1.0</b>	<b>0.7</b>	<b>0.6</b>
<b>Other macroeconomic variables</b>					
Debt to GDP ratio	60.1	67.3	68.5	69.3	68.9
Total Employment (growth rate)	-2.4	0.2	1.4	1.5	1.7
Unemployment rate (in percent)	20.1	19.8	18.5	17.3	16.0
Net Lending(+)/Borrowing(-) vis à vis RoW (percent of GDP)	-3.9	-3.4	-2.7	-2.3	-2.0

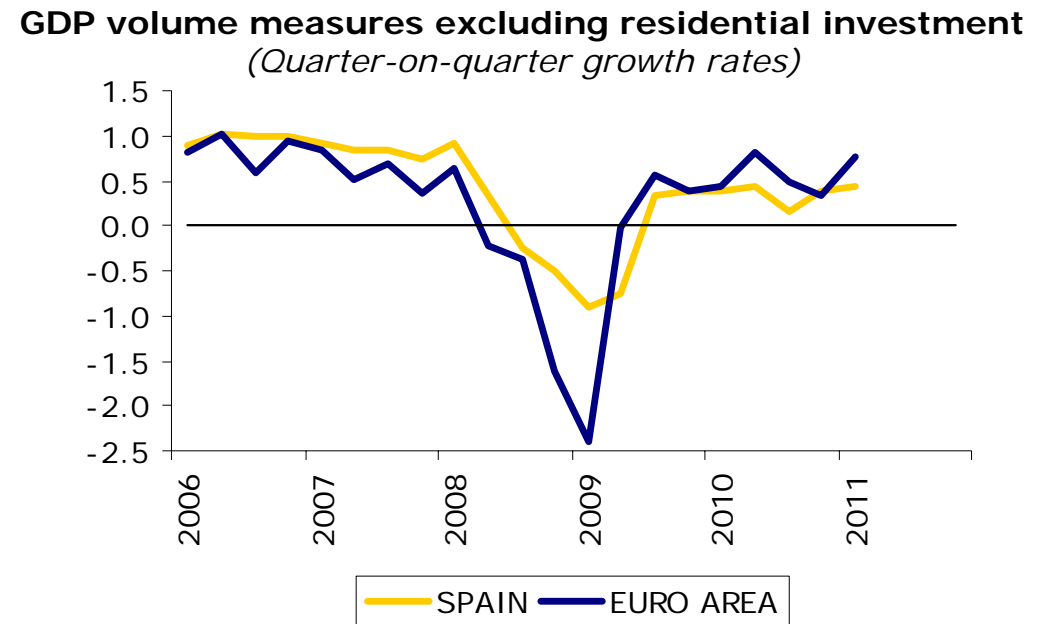
Source: [Ministerio de Economía y Hacienda](#).

## The adjustment in the residential sector in 2011

- The recovery of economic activity in Spain has been delayed and less intense than in the Euro Area. This is largely related to the abrupt adjustment of the housing sector
- Residential investment accounted for 4.4% of GDP in 1995 and it increased to 9.3% by 2006. In 2011-Q1 this ratio is already below the 1995 level of 4.4%
- Adjustment will be completed by end-2011: y-o-y growth of residential investment in 2010 (-16.8%) and 2011 (-5.0%), taking 1.0 and 0.2 p.p. off GDP growth, respectively



Source: [Eurostat](#).



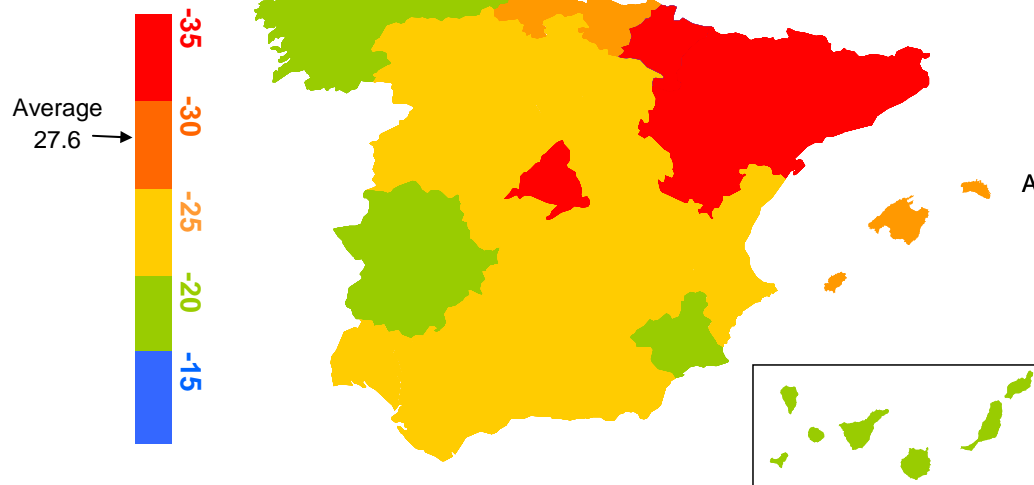
Source: [Eurostat](#).

## Housing stock is shrinking and prices are adjusting

- The rapid downsizing in the residential sector and trend housing demand (aprox. 350.000 units), will normalise the sector's macroeconomic impact
- The adjustment in housing prices in the Mediterranean coastline as well as in Madrid and its surroundings underway

### Real price adjustment of used houses per Autonomous Region

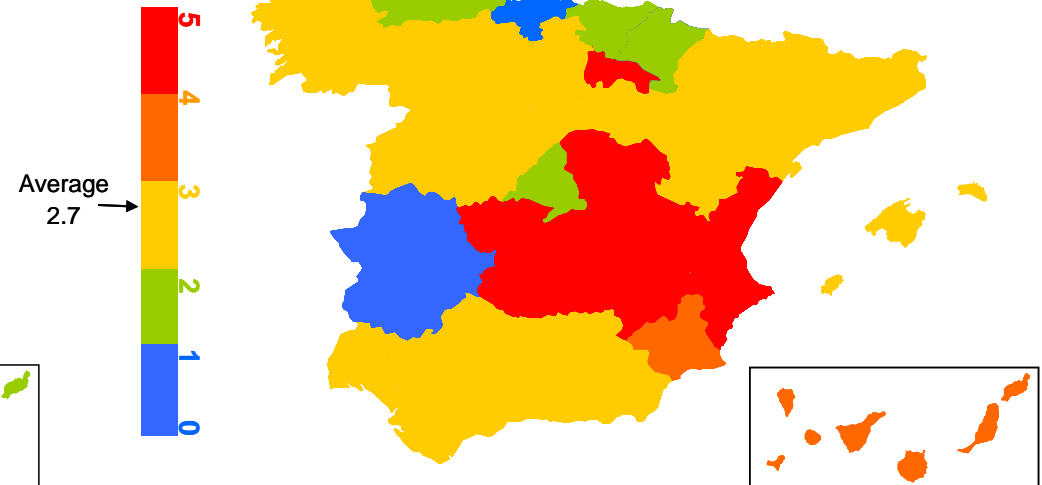
(From peak in each Region to 2011-Q1 in percent)



Sources: [INE](#) and [Ministerio de Fomento](#).

### Unoccupied housing stock per Autonomous Region

(2010, in percent of total stock in each Region)



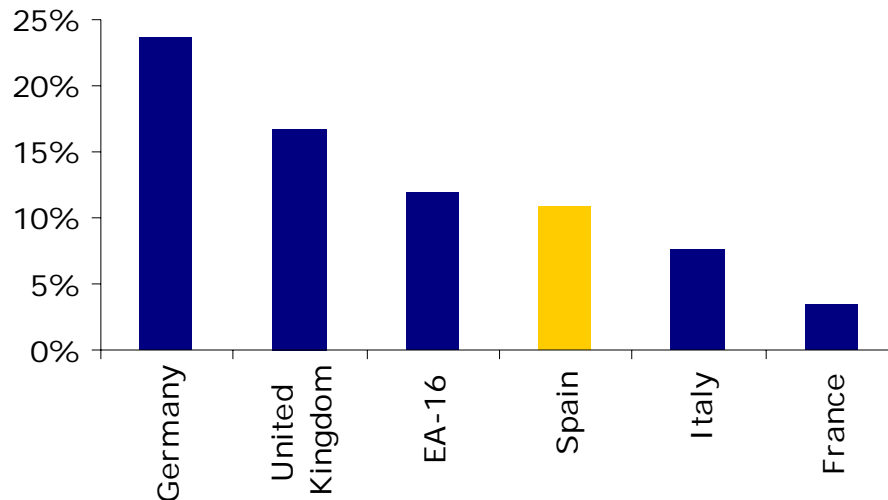
Source: [Ministerio de Fomento](#).



## Adjustment in real estate reduces aggregate leverage...

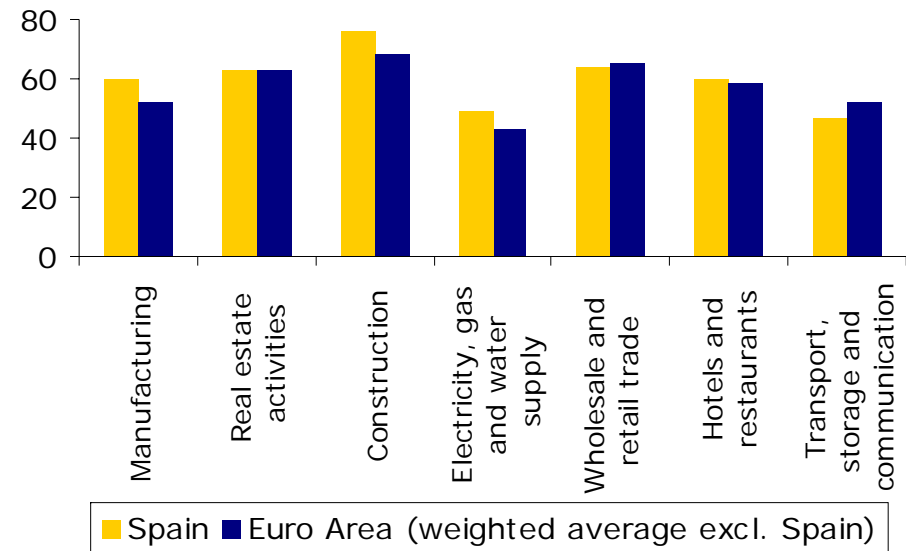
- Household leverage is related to high rate of home ownership. Once rent payments are considered, households' costs due to housing are not high in European context
- Corporate leverage: Firms in real estate were highly leveraged. Other sectors are comparable to Euro Area

**Housing cost overburden, 2009**  
(% of households with housing costs >40% of disposable income)



Source: [Eurostat](#).

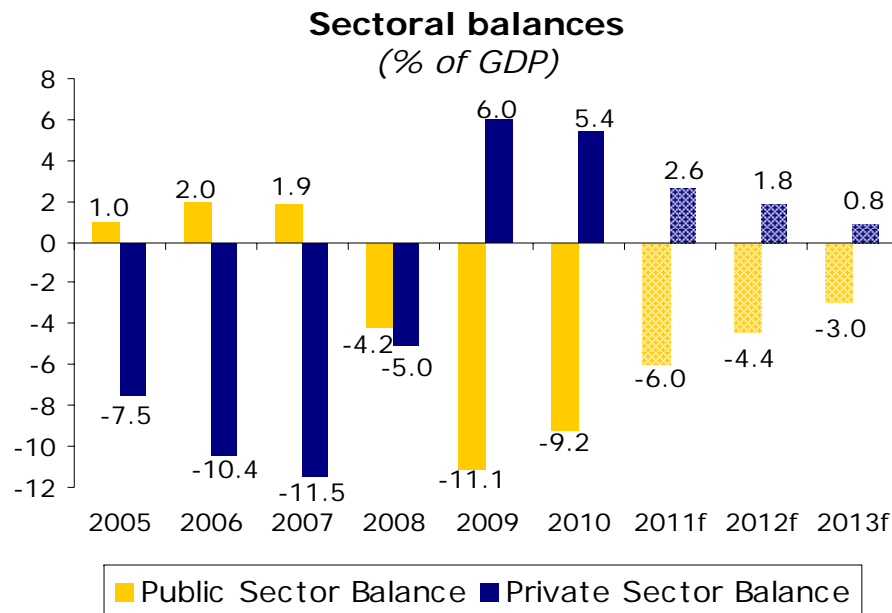
**Debt to total assets, 2007**



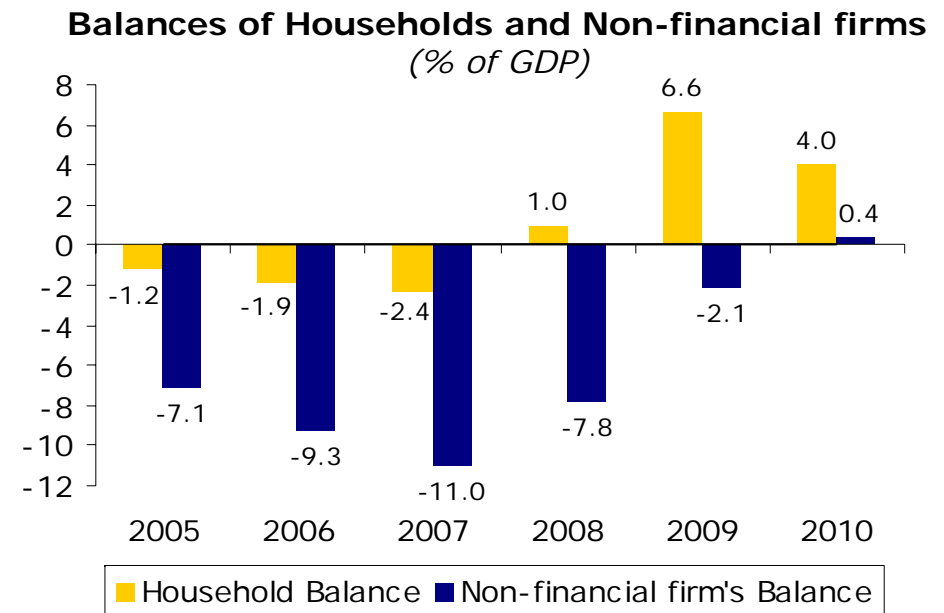
Source: [INE](#) and [Eurostat](#).

## ... and has been intense in households and non-financial firms

- High leverage was concentrated in real estate and construction
- Non-financial firms have also invested heavily abroad, seizing opportunities of global markets
- Deleveraging process in households is compatible with moderate consumption growth
- Credit will gradually approach nominal GDP growth



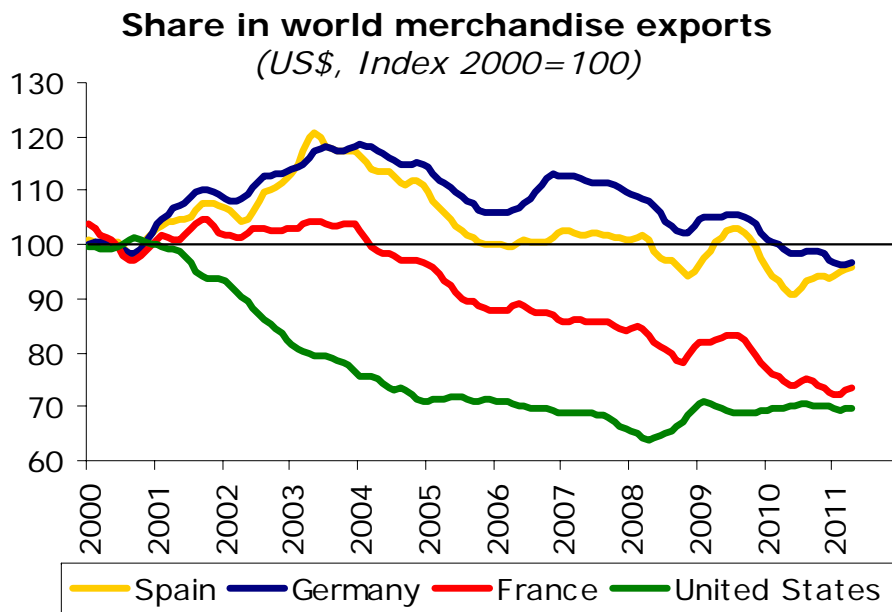
Source: [INE](#) and [Ministerio de Economía y Hacienda](#).



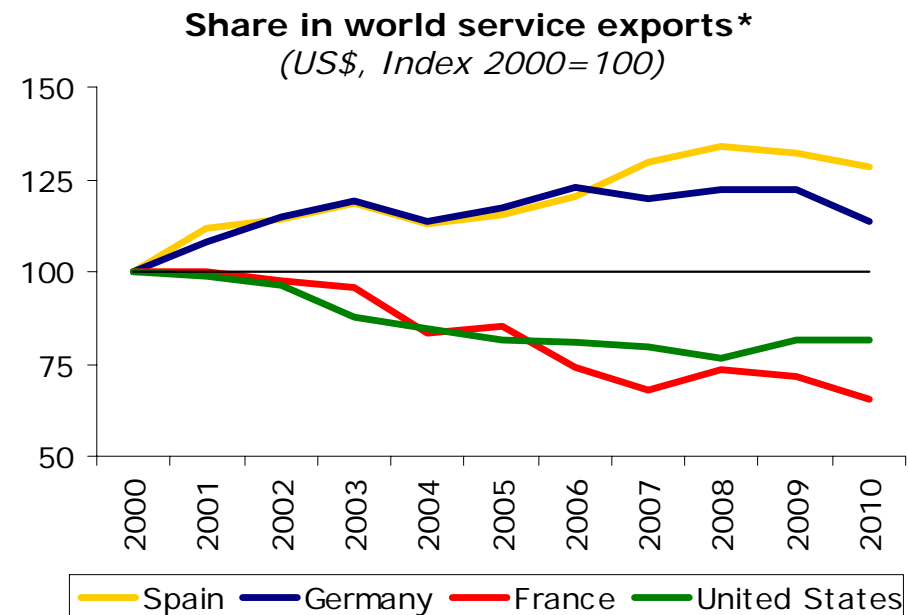
Source: [INE](#).

## Spanish firms are competitive

- Remarkable resilience of market share in world merchandise and of service exports other than transportation and tourism-related services
- Most developed economies' market share has decreased more over the recent years



Source: [IMF](#) and [World Trade Organisation](#).

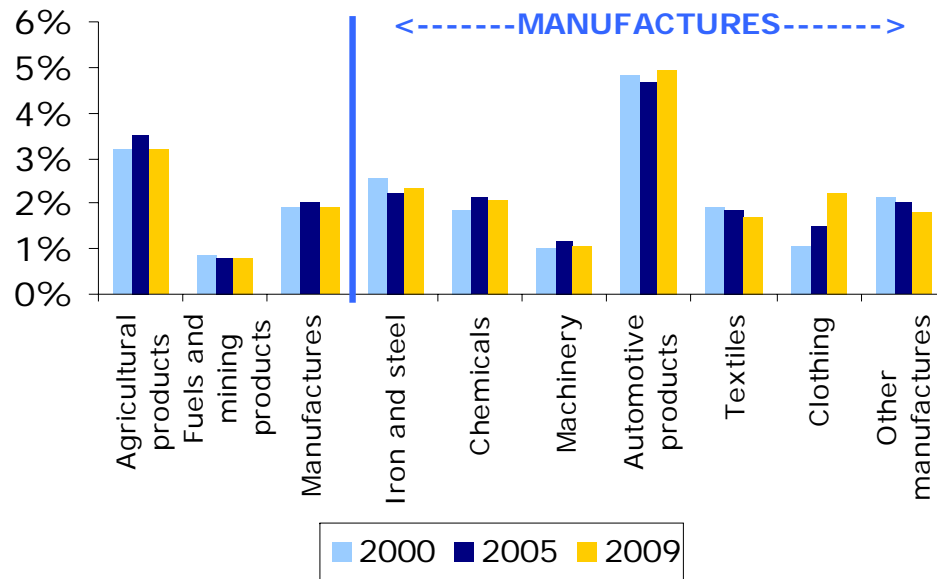


Source: [World Trade Organisation](#) and [Bank of Spain](#).  
\* Other than transportation and travel.

## General competitiveness and internationalisation

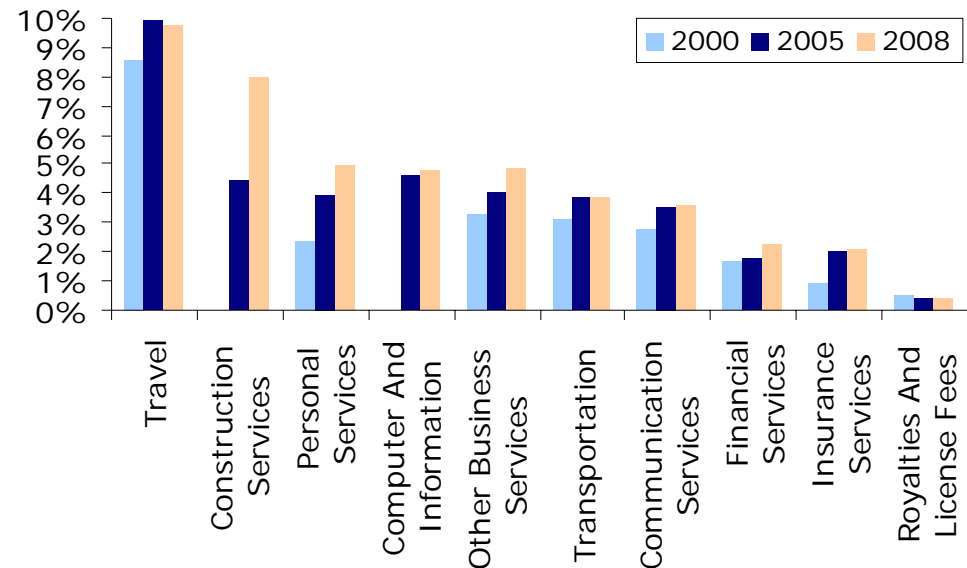
- Export performance is widespread and not attributable only to a handful of sectors
- Spanish exports are entering in new emerging markets: in 2009 (1999) 78.8% (82.5%) went to OECD and 56.7% (60.2%) to the Euro Area
- Large increase in Spanish investment abroad (FDI). In 2009 it weighted 44.2% of Spanish GDP while, on average, it was around 20% in the 1990's

Share in world merchandise exports by product



Source: [World Trade Organisation](#).

Share in world exports of services in the OECD

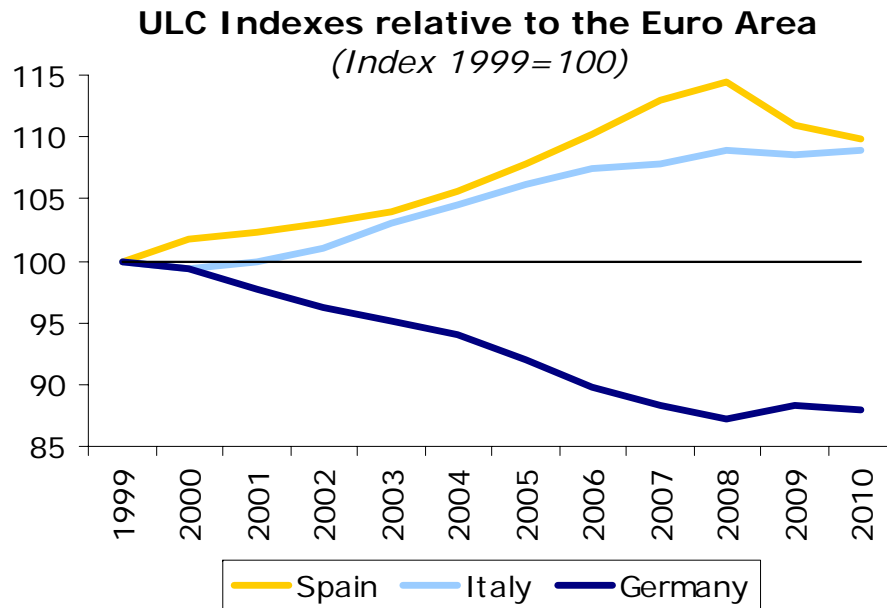


Source: [OECD](#).

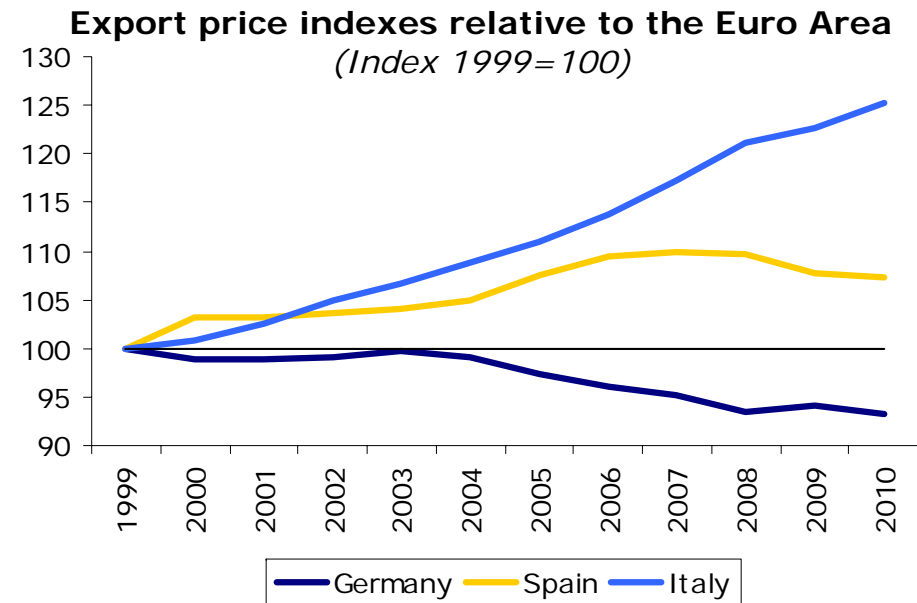


## In a period of increasing labour costs...

- Between 2000 and 2008, Spain faced an increase in labour costs relative to its European peers
- Price competitiveness has been improving due to the rebalancing and structural adjustment of the Spanish economy



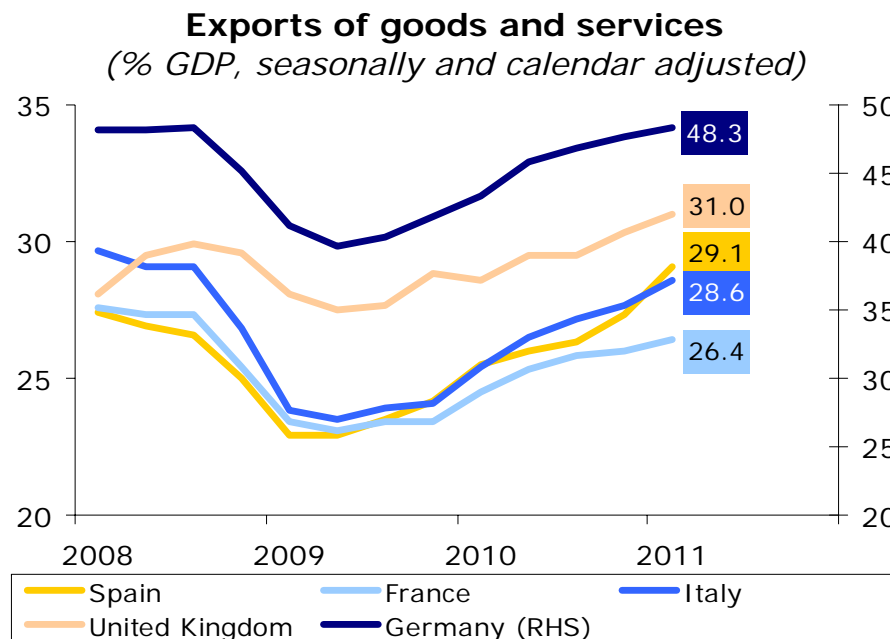
Source: [Eurostat](#).



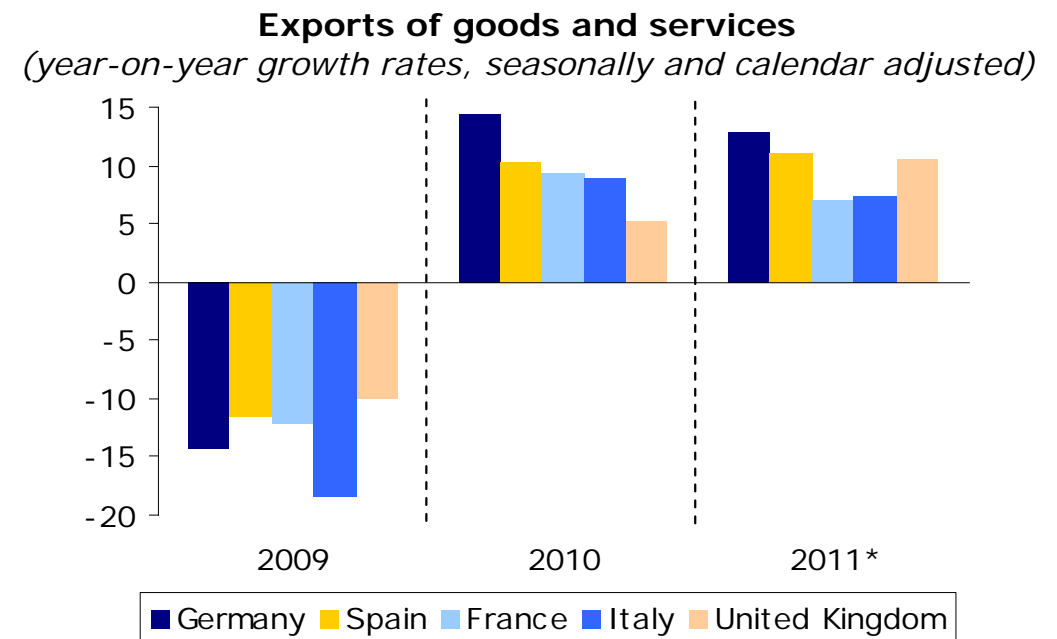
Source: [Eurostat](#).

## ...the recent improvement in cost-competitiveness has fostered exports further...

- The net borrowing of 11.4% of GDP in 2008-Q1 has shrunk to 4.7% in 2011-Q1, partly attributed to the adjustment in the residential real estate sector
- The current account deficit is adjusting due to the strong behaviour of exports. Exports are reacting to the downward pressure on domestic prices and labour cost moderation
- At end 2010 gross indebtedness vis-à-vis rest of the world reached 164.1%, 3% lower than in 2009



Source: [Eurostat](#).



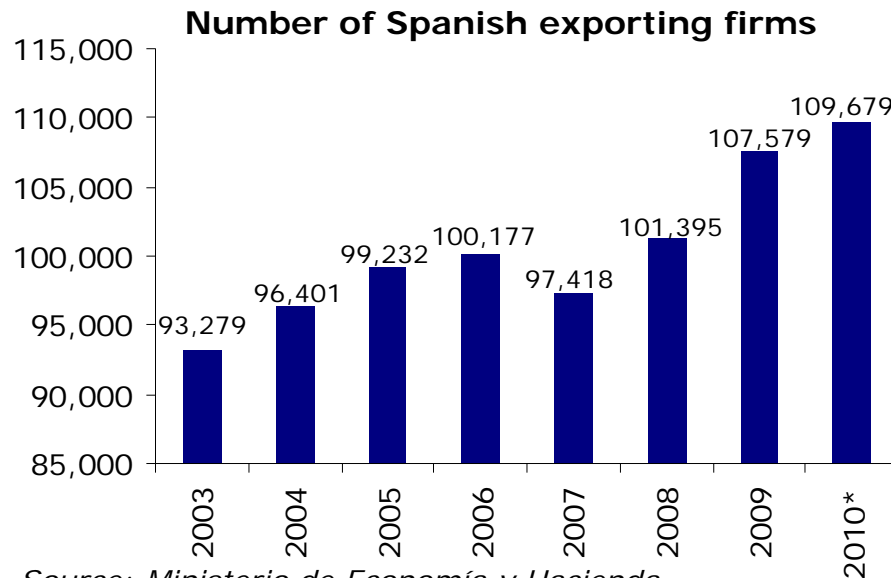
Source: [Eurostat](#) and National Statistical Offices.

\* 2011-Q1 Year-on-year growth rate.

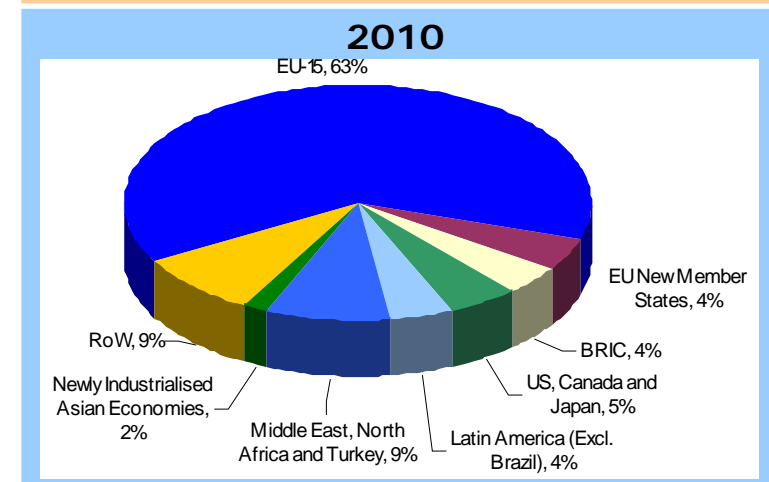
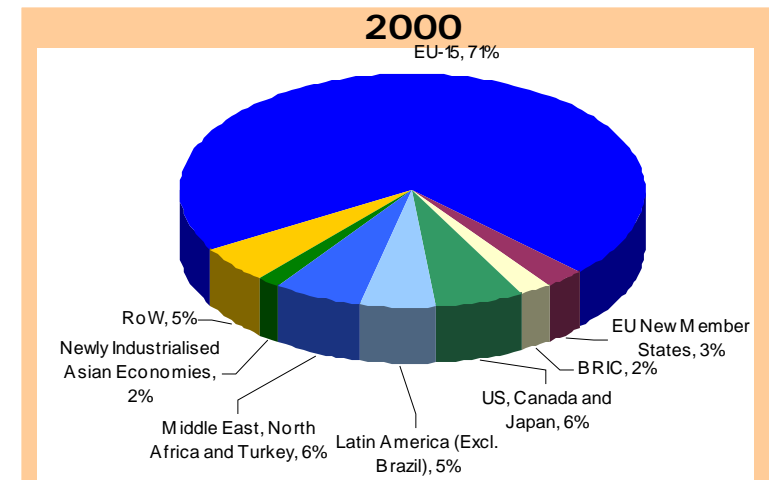


## ...mainly linked to higher number of exporting firms and international diversification

- The recovery in export performance is a consequence of higher extensive and intensive margins of Spanish exporting firms
- In this process diversification of exports has been key. Breakdown by destination between 2000 and 2010 shows that traditional markets have lost some weight, while less traditional markets (BRICs, new EU Member States, Turkey and MENA countries) have increased their shares within Spain's exports



Source: Ministerio de Economía y Hacienda.  
\* Provisional estimate



## A sustained growth path for the future

- The combination of structural reforms, the correction of macroeconomic imbalances and the existence of a competitive body of firms will sustain a growth path in the future
- Despite lower growth for 2011, projections for Spain in the medium-run are in line or above those for the Euro Area

Comparison of growth forecasts							
	Spain				Euro Area		
	MEH	IMF	OECD	EC	IMF	OECD	EC
2011	1.3	0.8	0.9	0.8	1.5	1.7	1.6
2012	2.3	1.6	1.6	1.5	1.8	2.0	1.8
2013	2.4	1.8			1.8		
2014	2.6	1.9			1.9		
2016-2025 *			2.3			1.7	

Sources: [Ministerio de Economía y Hacienda](#).

\* Potential output.



- **Reform strategy**
- **Fiscal consolidation**
- **Future balanced growth path**
- **Funding and Debt Management**

## Highlights of debt management

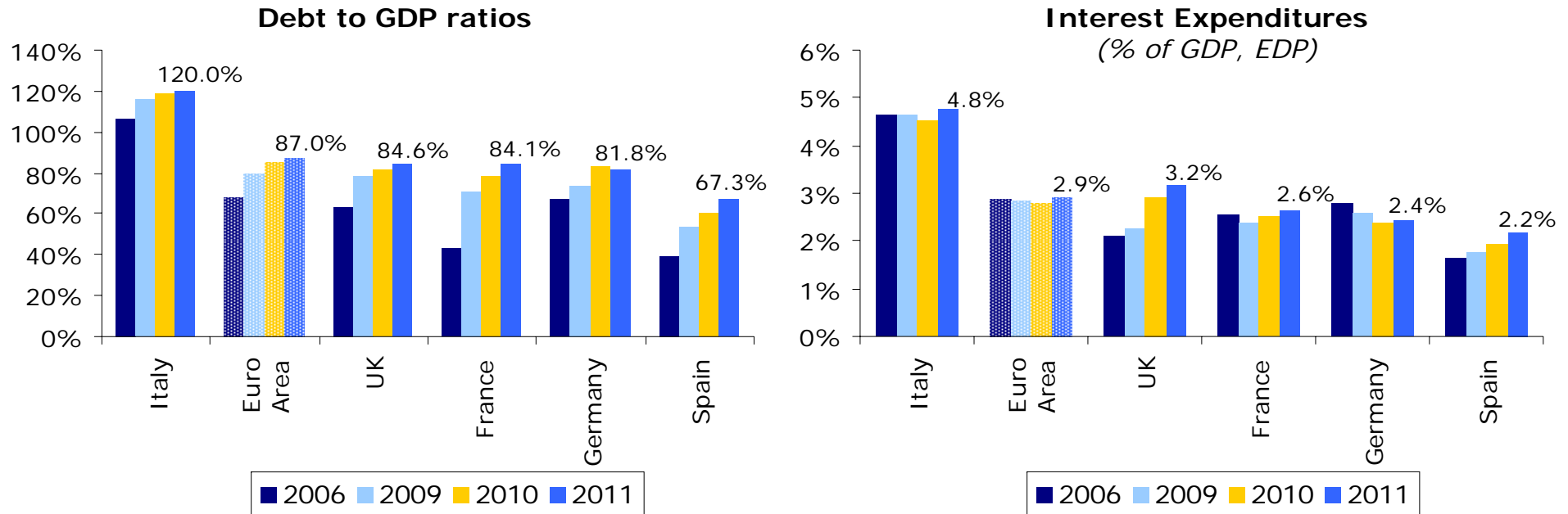
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- Substantial reduction of net issuance
- Lengthening of average life of debt outstanding
- A solid and diversified investor base, instrumental in difficult times
- Transparency and predictability highly valued by investors



## Debt to GDP well below EU average

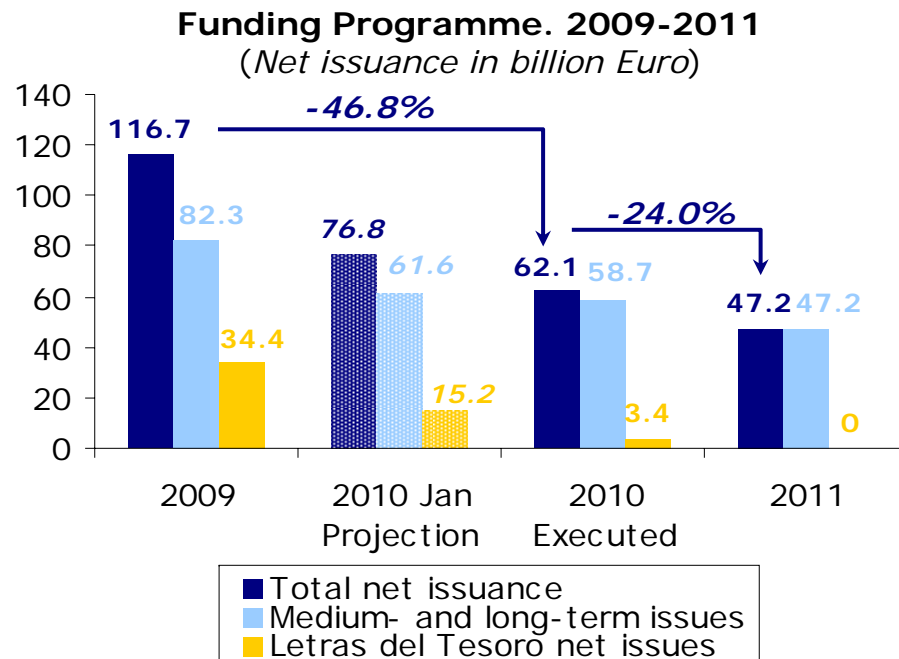
- 60.1% at end 2010 Spain's debt to GDP ratio was 25% lower than the Euro Area average
- A lower debt burden provides resiliency in terms of interest payments and refinancing needs (1.9% of GDP in 2010, projected at 2.2% in 2011)



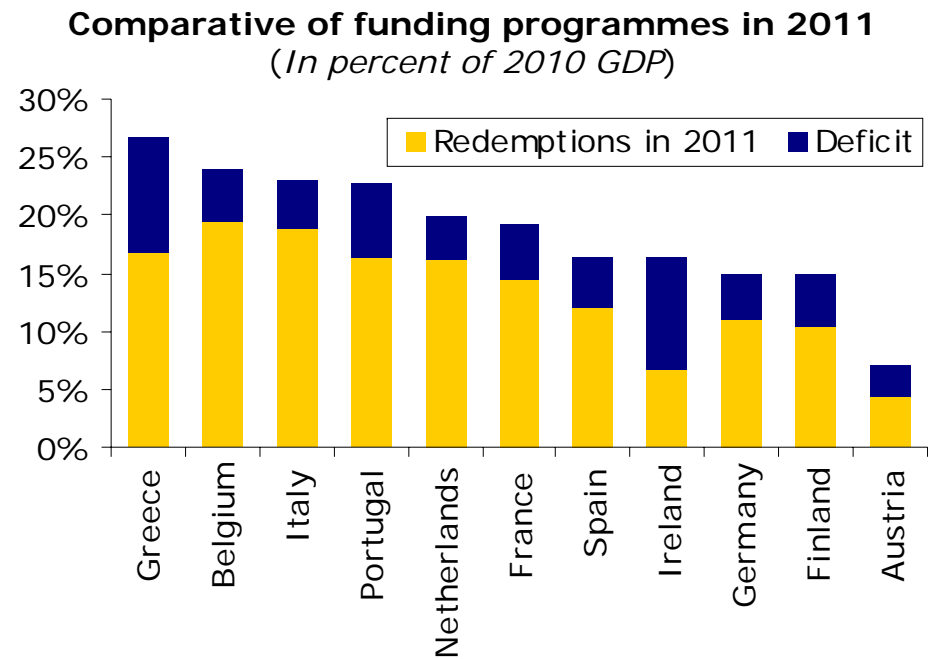
Sources: [Eurostat. EDP Notification Tables March 2011.](#)

## Funding programme in perspective

- Substantial reduction in net issuance: austerity measures and a better-than-expected performance of tax revenues have reduced the Central Government's borrowing needs
- Net issuance in 2010 (€62.1 bn) 27% lower than initially projected (€76.8 bn)
- Trend continued in 2011's Funding Programme



Source: [Dirección General del Tesoro y Política Financiera](#).



Source: Bloomberg.

## The funding programme in 2011

- Funding requirement down by 24% in accordance with frontloading of fiscal restraint measures, without factoring in any potential proceeds from privatisation processes
- As of July 31<sup>st</sup>, the gross issuance of medium- and long-term bonds stands at €55.4bn, 59.1% of the initially projected figure

<b>Tesoro funding in 2011 (Billion Euro)</b>	
<b>1: Funding requirement (=Net Issuance)</b>	<b>47.2</b>
2: Redemptions of medium- and long-term bonds	-46.6
3: Net issuance medium- and long-term bonds	47.2
<b>4 = 2 + 3: Gross issuance of medium and long-term bonds</b>	<b>93.8</b>
5: Net increase in T-Bills	0.0
6 = 5 + 3: Net change in outstanding debt	47.2
<b>7: Forecast Outstanding Central Government Debt at end 2011</b>	<b>588.0</b>

Source: [Dirección General del Tesoro y Política Financiera](#).

- Since July 29<sup>th</sup> a modification has been introduced to the tax procedure, intended primarily to simplify the obligations of non-resident investors in fixed income financial instruments for the actual perception of their interest income free of withholding taxes. As a result of the technical amendments, the previously existing investor identification obligations are eased and broadened in their geographical scope

## Outlines of the 2011 funding programme

---

### Medium and long term:

- Increased flexibility in auction procedures: Monthly announcements + potential off-the-run lines announced Friday prior to the auction
- Limit size per line: 16.5 bn € for lines of 10-years and above

### Short term:

- 3- and 6-month Letras auction 4<sup>th</sup> Tuesday of every month
- 18-month and 12- month T-bills auction 3<sup>rd</sup> Tuesday of every month

### Other funding sources:

- Tesoro Público is open to additional foreign currency issuance
- Floating rate notes have provided in 2009 and 2010 an additional funding source
- Private placements
- Schuldschein loans

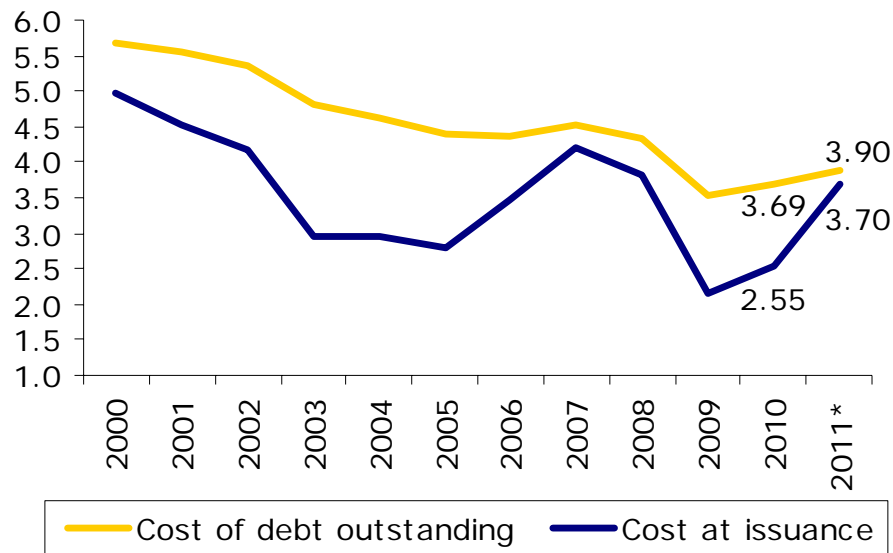
### Projects:

- European inflation-linked issues (HICP-ex tobacco)

## Positive funding execution snapshots

- Support the normalisation of market functioning through transparency and predictability via auctions
- On-going engagement with our investor base to update on the implementation of policy strategy and economic and budgetary developments

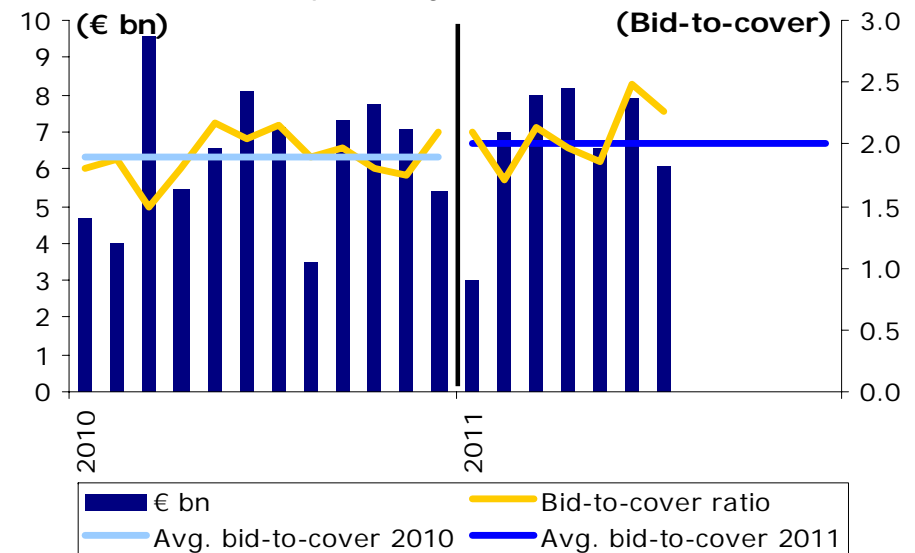
Cost of debt outstanding and cost at issuance  
(in percent)



Source: [Dirección General del Tesoro y Política Financiera](#).

\* As of July 31<sup>st</sup> 2011.

Auctions of Bonos and Obligaciones  
(up to July 31<sup>st</sup> 2011)

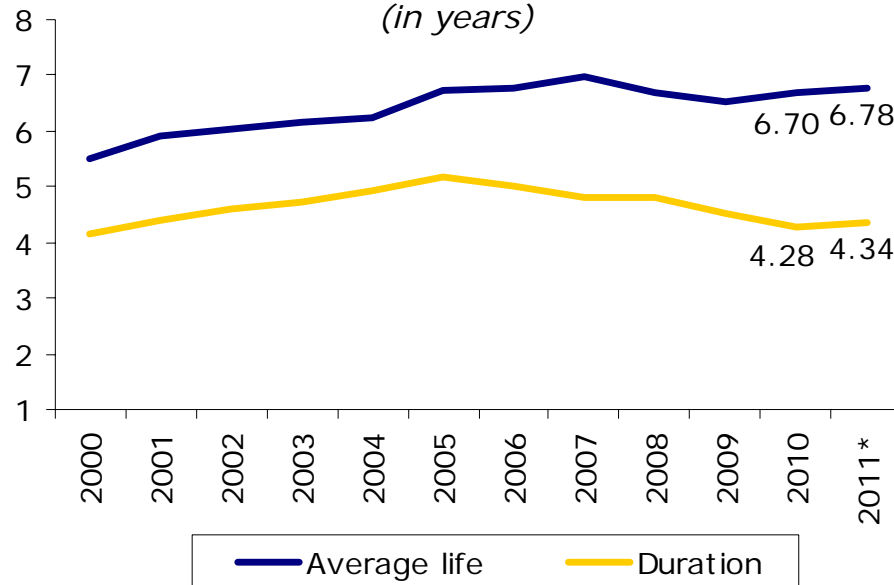


Source: [Dirección General del Tesoro y Política Financiera](#).

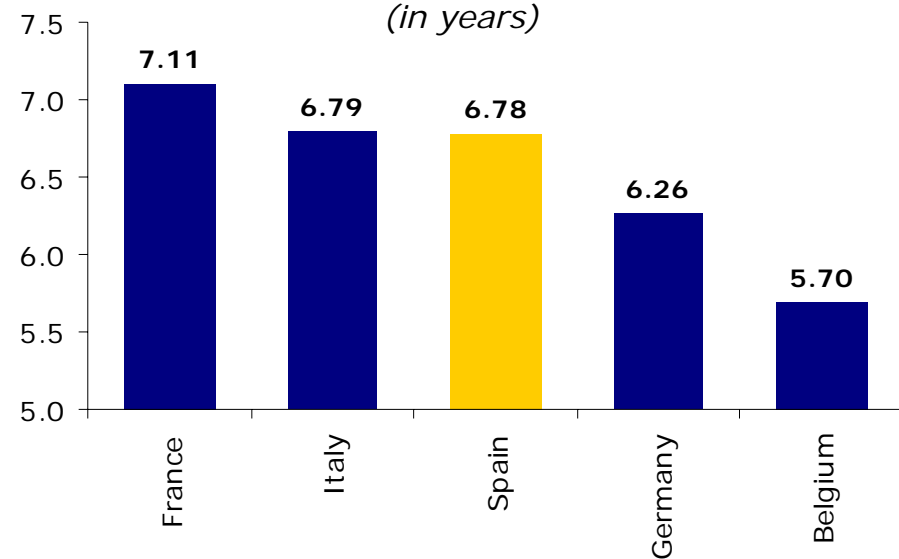
## Lengthening of average life has enabled a prudent debt management

- Average life has increased thanks to a reduced issuance of T-Bills and focus on medium- and long-term supply
- Effort to achieve additional lengthening of average life has enabled a prudent debt management

**Duration & Average Life to Maturity of the Portfolio.**  
**As of July 31<sup>st</sup> 2011**  
(Letras, Bonos and Obligaciones)  
(in years)



**Average life to Maturity. As of July 31<sup>st</sup> 2011.**  
(T-Bills and medium and long-term euro-denominated debt,  
excluding inflation-linked bonds)  
(in years)

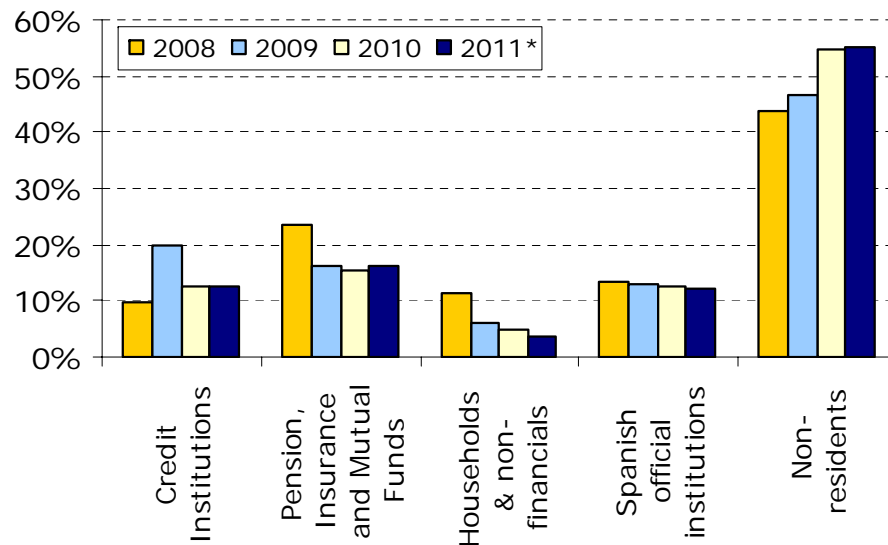


Sources: [Dirección General del Tesoro y Política Financiera](#) and Bloomberg.

## A stable investor base

- Non-resident investors have been of instrumental importance throughout various periods of uncertainty in 2010 and 2011
- The geographical distribution of holdings of government bonds has remained relatively stable during the last two years

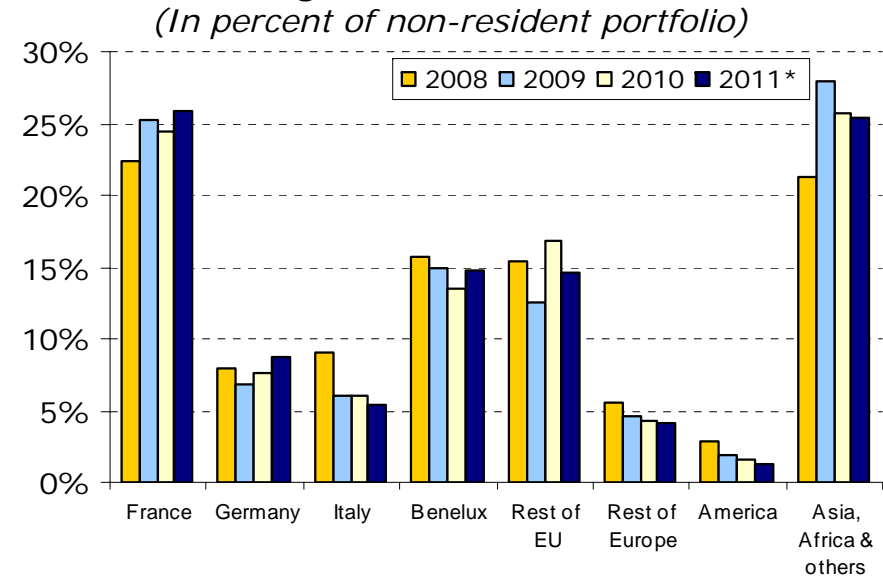
**Total unstripped Government debt by Holder**  
*(Registered. In percent of total portfolio)*



Source: [Dirección General del Tesoro y Política Financiera](#).

\* As of June 30<sup>th</sup> 2011.

**Geographical distribution of non-resident holders of government debt**  
*(In percent of non-resident portfolio)*



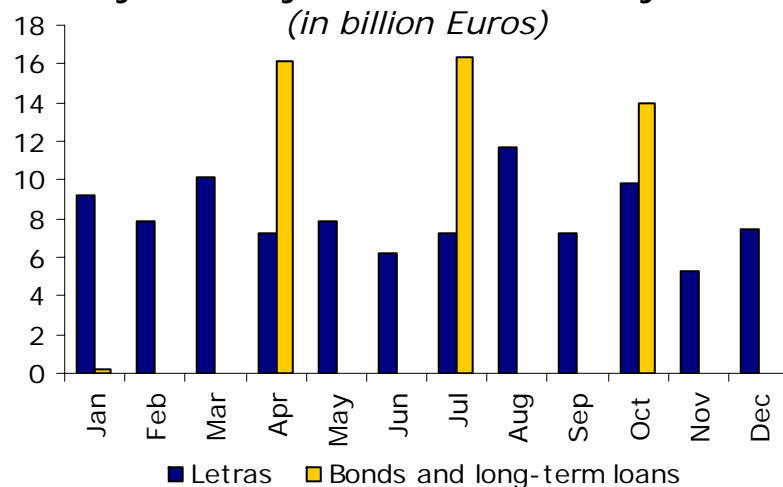
Source: [Dirección General del Tesoro y Política Financiera](#).

\* As of June 30<sup>th</sup> 2011.

## Robust Treasury Management System

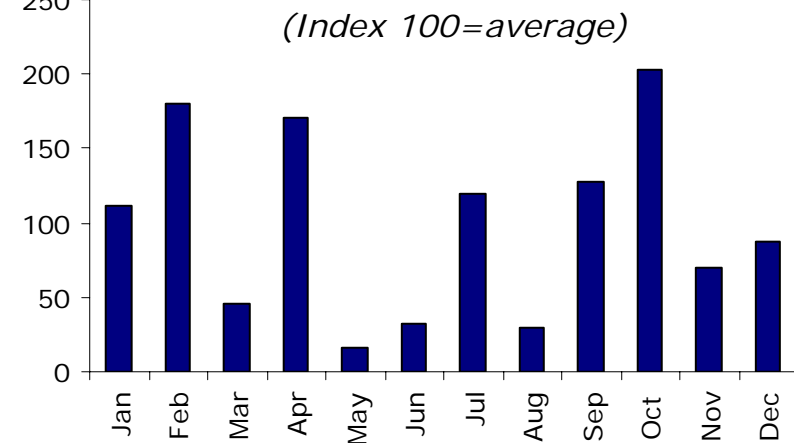
- Redemption dates of medium- and long-term bonds (principal and coupons) are set to coincide with biggest inflows of tax revenues
- Liquidity lines with banks
- Transparency: regular and publicly available information about budgetary execution, change in cash balances, non resident holdings,...
- Issuance schedule based on very conservative assumptions about budget execution
- Excess liquidity is lent in the money market each day through a monthly auction since 2001

**Monthly maturity structure as of July 31<sup>st</sup> 2011**



Source: [Dirección General del Tesoro y Política Financiera](#).

**Average seasonal index of tax revenues of the Central Government 2008-2010**

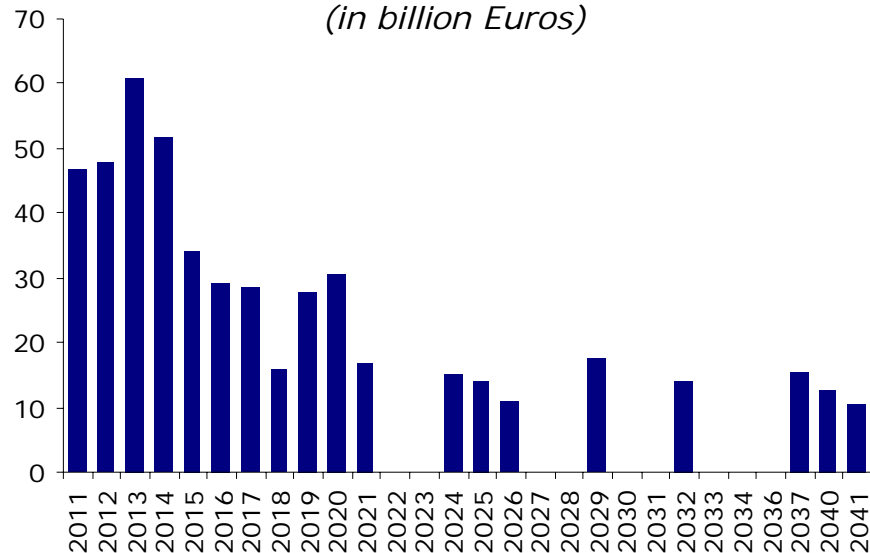


Source: [IGAE](#).

## Risk and refinancing measures

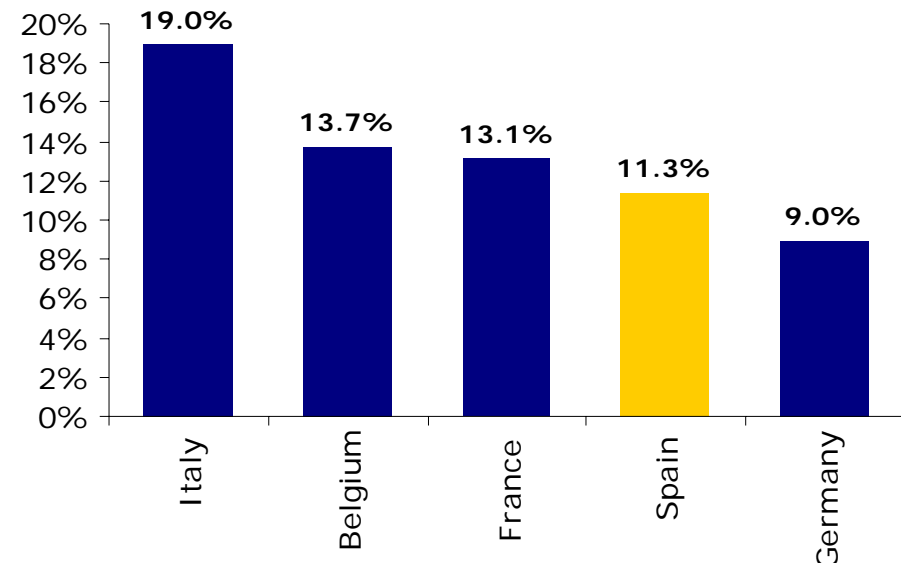
- Refinancing risk remains subdued due to lengthening of average life
- Redemptions of Euro-denominated debt remain well in line with those of peers

**Maturity structure of medium- and long-term bonds**  
(in billion Euros)



Source: [Dirección General del Tesoro y Política Financiera](#).

**Redemptions August 2011 to July 2012**  
(in % of 2011 GDP, Euro-denominated bonds and T-Bills)



Source: [Dirección General del Tesoro y Política Financiera](#) for Spain, Bloomberg for other countries and [EDP Notification Tables March 2011](#), Eurostat.

## More and updated information on the Spanish economy

<http://www.thespanisheconomy.com>



For data sources, please click links below each figure or table

## Thank you for your attention

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