

ANNUAL REPORT 2015

CHAPTER 1

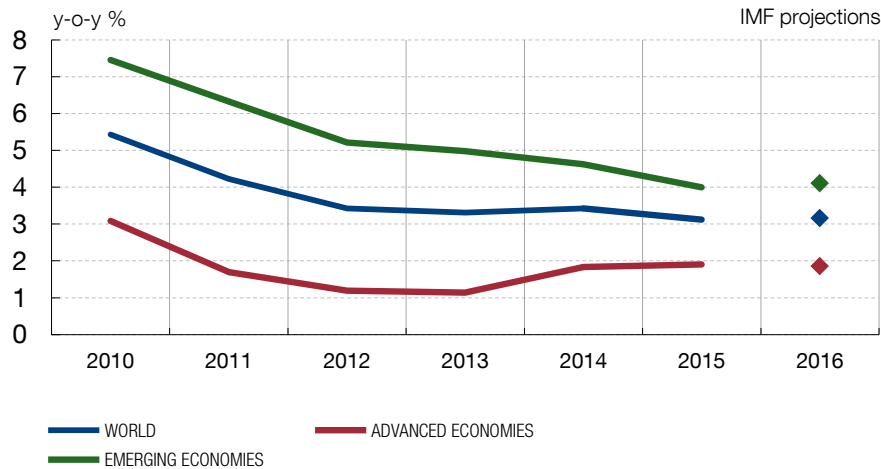
OVERVIEW

THE WORLD ECONOMY IN 2015



Conditioning factors behind the lower global growth were the re-balancing of the Chinese economy, the acceleration of the fall in oil prices and expectations of monetary normalisation in the United States.

GDP GROWTH AND IMF FORECASTS



COMMODITIES PRICES



THE MODEST RECOVERY IN THE EURO AREA



The build-up of downside risks to the price stability target and signs of the de-anchoring of inflation expectations led the ECB to extend its asset purchase programme in early 2015 and to approve further stimulus measures in December 2015 and March 2016.

HARMONISED INDICES OF CONSUMER PRICES



EURO AREA INFLATION EXPECTATIONS DERIVED FROM INFLATION-LINKED SWAPS

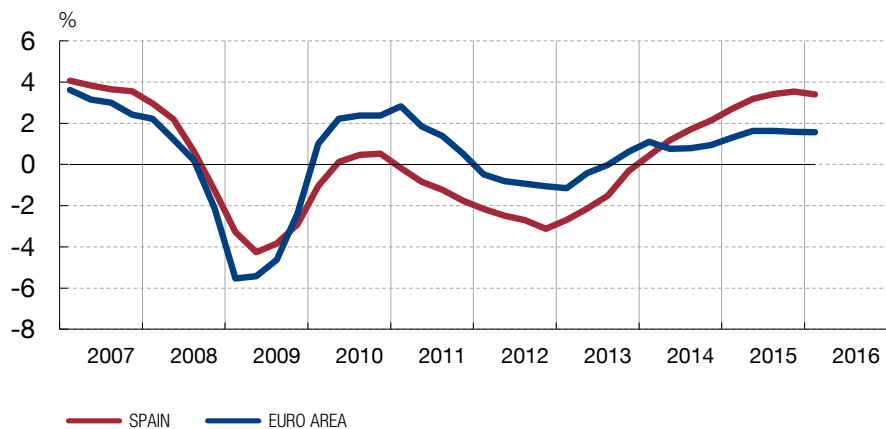


THE CONTINUATION OF THE SPANISH RECOVERY

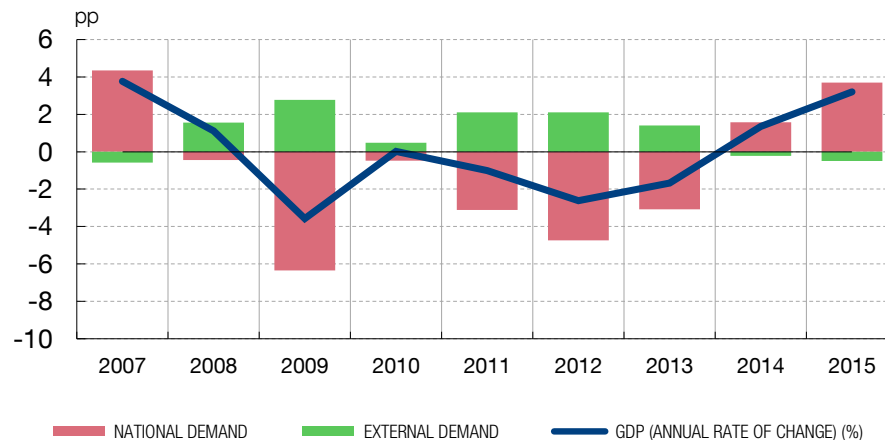


In 2015 the pace of recovery stepped up, to a rate (3.2%) appreciably higher than that recorded by Spain's European partners.

GROSS DOMESTIC PRODUCT



GDP, NATIONAL DEMAND AND EXTERNAL DEMAND



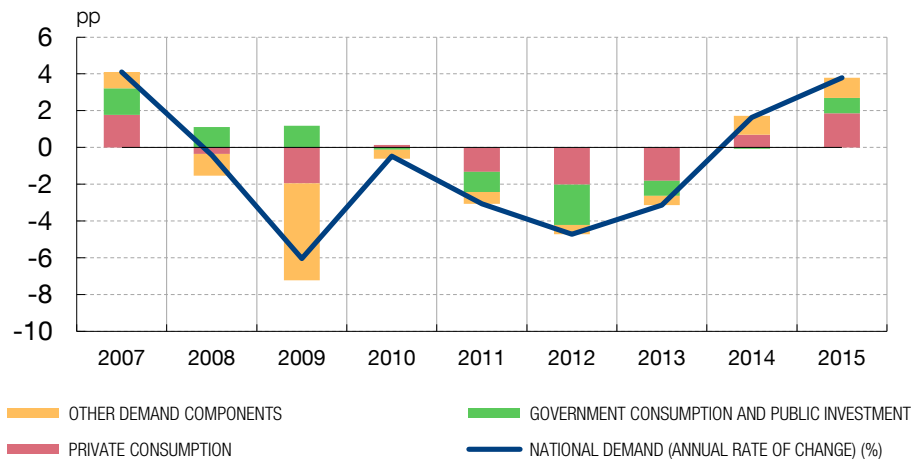
THE CONTINUATION OF THE SPANISH RECOVERY



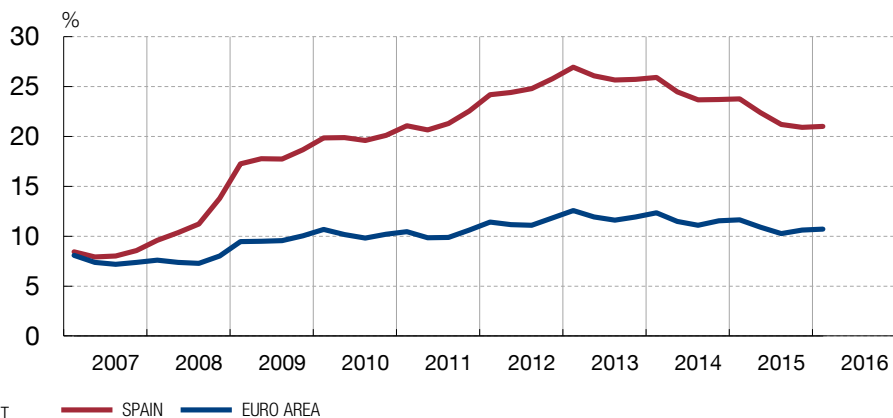
Household expenditure and business investment were markedly dynamic in 2015; the contribution of external demand to growth was negative; and government consumption and public investment moved on an expansionary course.

Employment grew forcefully across practically all sectors, and the pace of decline of the unemployment rate increased.

NATIONAL DEMAND AND COMPONENTS



UNEMPLOYMENT RATE

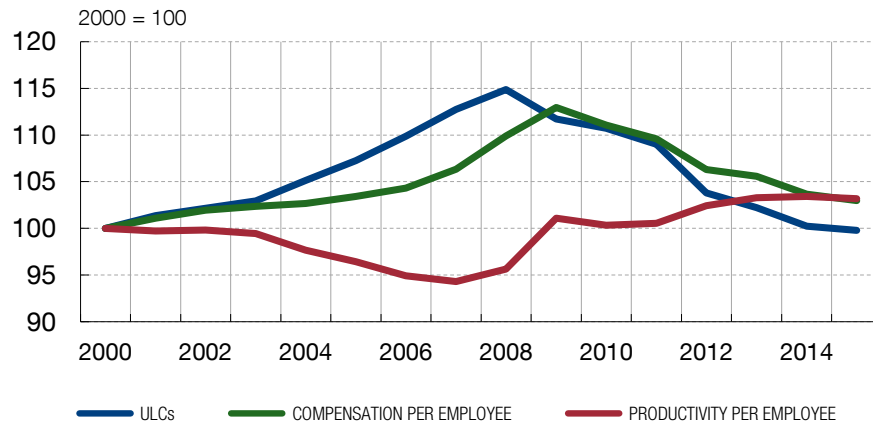


DETERMINANTS OF GROWTH IN 2015

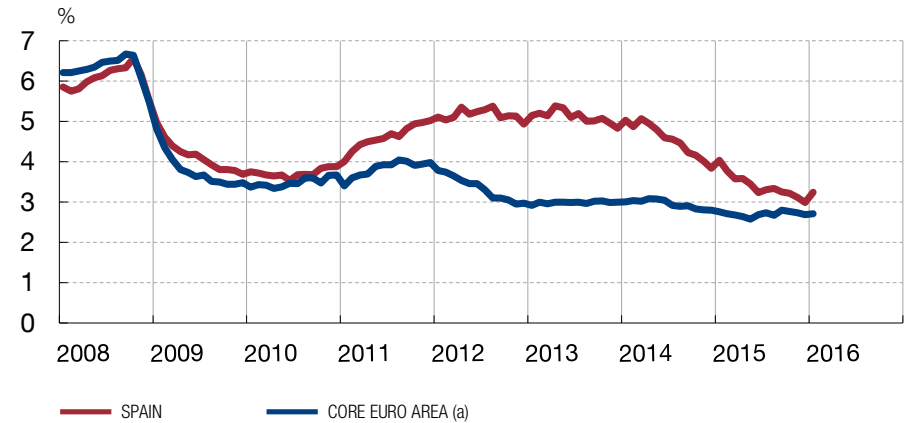


Growth continued to be underpinned by structural factors, linked to improved competitiveness, the progressive restoring of macrofinancial equilibria and the easing in financing conditions for households and firms...

UNIT LABOUR COSTS IN SPAIN RELATIVE TO THE EURO AREA



INTEREST RATES ON LOANS < €1 MILLION



a The euro area core comprises the following countries: Germany, Austria, France, Netherlands, Finland and Luxembourg.

The policies and reforms applied both domestically and at the European level have contributed to correcting the imbalances that built up.

THE RELEVANCE OF TEMPORARY FACTORS



... and other temporary factors also contributed, including most notably the fall in oil prices, the depreciation of the euro and demand-side (monetary and fiscal) policies.

EFFECT OF THE CHANGE IN THE EXOGENOUS ASSUMPTIONS SINCE MID-2014 ON GDP GROWTH AND INFLATION FOR 2015

| | GDP | Inflation |
|----------------------------------|------------|-------------|
| Monetary policy | 0.6 | 0.6 |
| Fiscal policy | 0.5 | 0.2 |
| Global demand | -0.6 | -0.1 |
| Oil and other commodities prices | 0.6 | -2.3 |
| TOTAL | 1.1 | -1.6 |

The lesser contribution of the temporary factors that have boosted activity suggests more moderate growth in the short and medium term.

CHALLENGES OUTSTANDING: REDUCING UNEMPLOYMENT

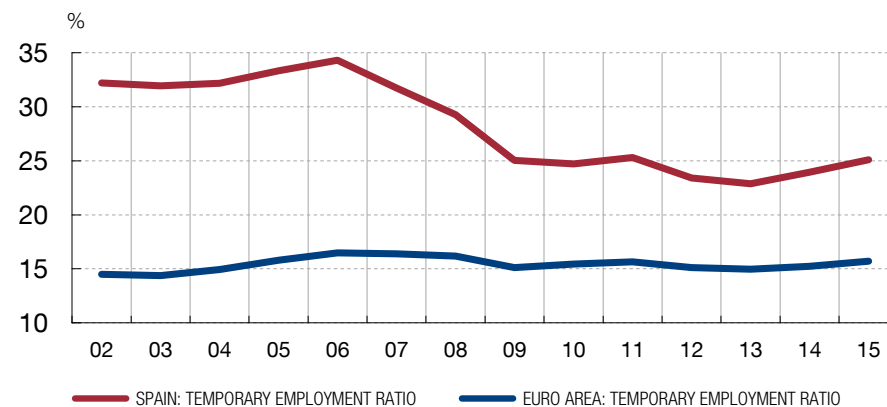
The challenges in the labour market are associated with the persistence of high unemployment rates, the scant link between wages and firms' specific conditions and the high temporary employment ratio.

These challenges require measures to provide for a closer alignment of firms' conditions with their specific situation, to boost the attractiveness of permanent hiring and to improve active policies.

UNEMPLOYMENT, LONG-TERM UNEMPLOYMENT AND VERY LONG-TERM UNEMPLOYMENT

| | Unemployment rate | Incidence of long-term unemployment | Incidence of very long-term unemployment |
|------|-------------------|-------------------------------------|--|
| 2006 | 8.5 | 25.7 | 13.0 |
| 2007 | 8.2 | 23.8 | 12.3 |
| 2008 | 11.3 | 21.5 | 9.9 |
| 2009 | 17.9 | 28.6 | 10.5 |
| 2010 | 19.9 | 42.6 | 17.0 |
| 2011 | 21.4 | 48.2 | 24.7 |
| 2012 | 24.8 | 52.4 | 29.9 |
| 2013 | 26.1 | 58.5 | 36.1 |
| 2014 | 24.4 | 61.8 | 42.5 |
| 2015 | 22.1 | 60.9 | 44.2 |

TEMPORARY EMPLOYMENT RATIO (a)



a Temporary employees as a proportion of total employees, calculated with Q2 data for each year.

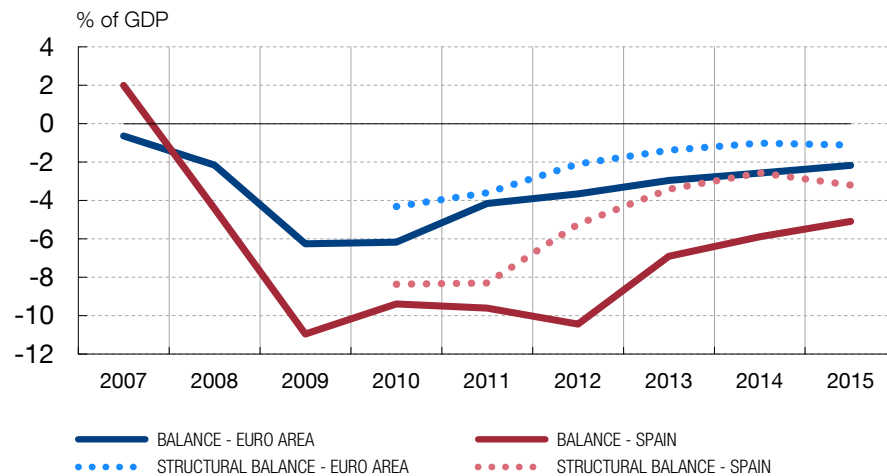
CHALLENGES OUTSTANDING: FISCAL CONSOLIDATION



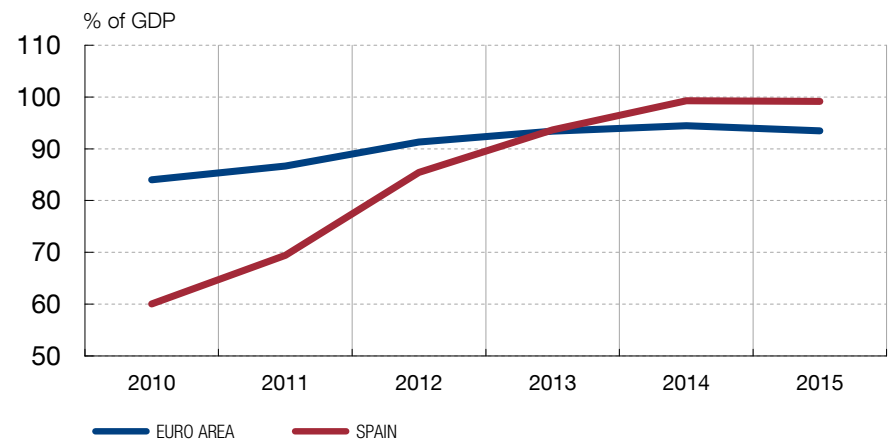
In 2015 there was a deterioration in the structural deficit and significant slippage by the budget deficit from the target set by the European authorities.

A detailed medium-term consolidation programme, the strict application of the Budgetary Stability Law, a composition of public finances more conducive to growth and a response to the challenges posed by population ageing are all required.

BALANCE AND STRUCTURAL BALANCE



EDP DEBT

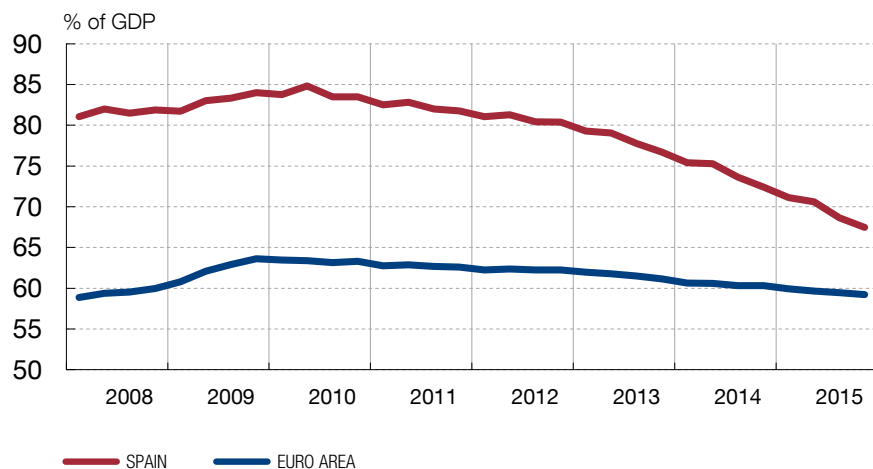


CHALLENGES OUTSTANDING: PRIVATE-SECTOR DELEVERAGING

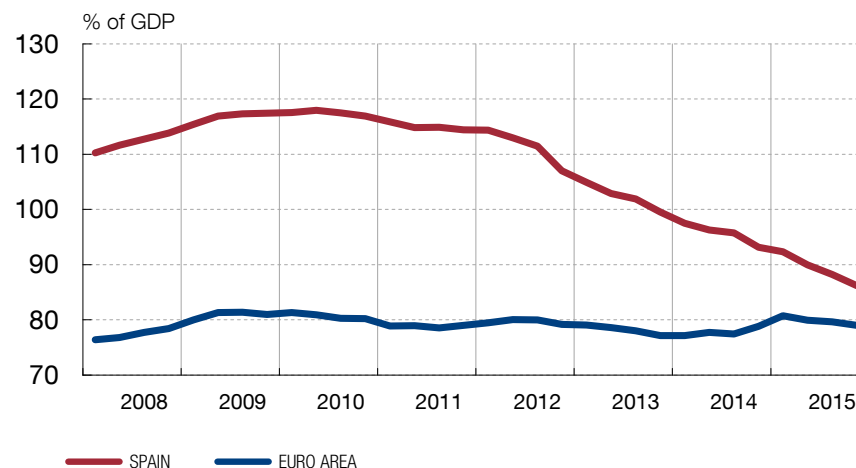


Households' and firms' debt ratio continued to decline in 2015; but the decline was nevertheless compatible with a pick-up in the flow of new financing transactions.

DEBT RATIO. HOUSEHOLDS



DEBT RATIO. NON-FINANCIAL CORPORATIONS



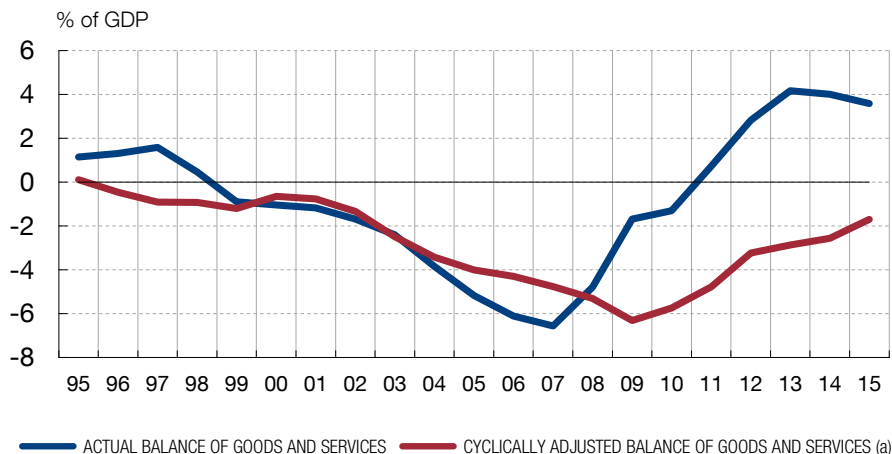
The decline in the aggregate balance of lending to firms has been accompanied by a significant inter-sectoral and intra-sectoral reallocation.

CHALLENGES OUTSTANDING: THE CORRECTION OF THE EXTERNAL DEBT POSITION



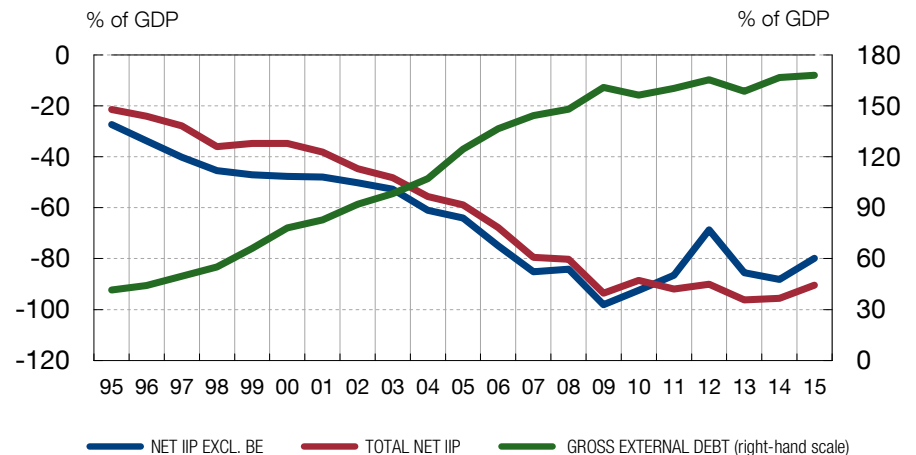
There has been a structural improvement in the trade balance and a pick-up in national saving, but the net debtor position vis-à-vis the external sector remains at very high levels.

BALANCE OF GOODS AND SERVICES
2010 constant prices



a Trade balance had both the Spanish economy and its main trading partners grown at a similar rate to the potential GDP rate.

NET INTERNATIONAL INVESTMENT POSITION (IIP) AND GROSS EXTERNAL DEBT POSITION



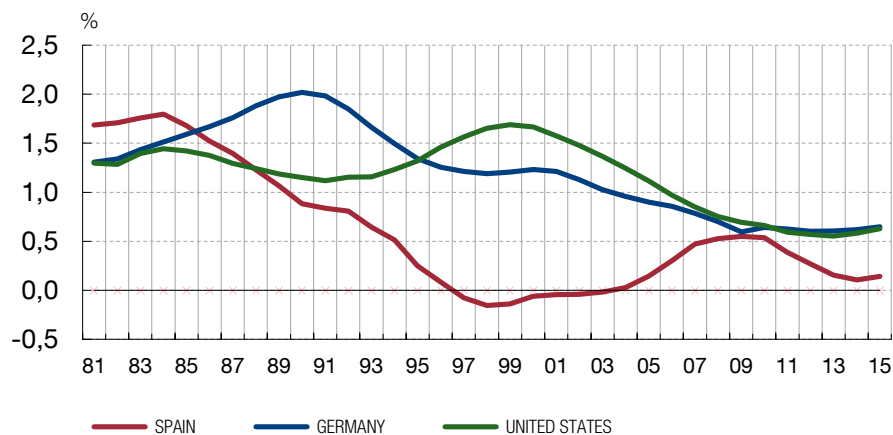
CHALLENGES OUTSTANDING: IMPROVING PRODUCTIVITY



Increasing productivity is crucial for improving growth prospects, especially against a background of population ageing. However, productivity growth in the Spanish economy is holding at a significantly lower rate than that of other developed countries.

To improve the dynamism of productivity calls for a reform of the regulation of certain sectors, the boosting of human and technological capital, enhanced institutional quality and a revision of the rules hampering business start-ups and growth.

TOTAL FACTOR PRODUCTIVITY GROWTH



POTENTIAL GROWTH AND CONTRIBUTIONS

| | 2001-2007 | 2008-2014 | 2015-2025 |
|-----------------------|-----------|-----------|-----------|
| Potential growth | 3.04 | 0.60 | 1.0 |
| Contributions | | | |
| Employment | 1.60 | -0.20 | 0.0 |
| Hours per employee | -0.20 | -0.10 | -0.1 |
| Employees | 1.80 | -0.10 | 0.1 |
| Population aged 15-64 | 1.00 | 0.00 | -0.3 |
| Participation rate | 0.90 | 0.30 | 0.1 |
| NAIRU-PC | -0.10 | -0.40 | 0.3 |
| Capital | 1.57 | 0.60 | 0.4 |
| TFP | -0.14 | 0.20 | 0.6 |

CHALLENGES OUTSTANDING: PROGRESS IN THE CONSTRUCTION OF EMU



In the short term, greater economic policy coordination is called for.

- The creation of an independent European Fiscal Council, and the promotion of competitiveness councils.
- To complete the Banking Union and thereby ensure a level playing field for banking systems.
- To complete financial integration with the Capital Markets Union.

In the medium term, the institutional architecture is still to be completed.

- Creation of a Fiscal Union promoting macroeconomic stabilisation in the euro area.
- Structural convergence in areas such as labour markets and fiscal systems.