SPAIN’S ECONOMIC POLICY STRATEGY

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Minister of Economy and Competitiveness

October 2012
Accumulated Imbalances of the Spanish Economy

1. Private sector indebtedness
Fast credit growth in 2003-09, encouraged by the lax monetary policy stance, was financed with external debt

2. Housing Bubble
82% increase in housing prices from 2003 to peak in 2008

3. Loss of Competitiveness
Drastic increase (30%) in Unit Labour Costs since joining the Eurozone

Manufacturing ULC (1998=100)
Consequences of the accumulated imbalances

1. Deterioration of Public Finances
   The public deficit soared as a result of a strong discretionary fiscal expansion (reflected in the structural deficit trend).

2. Increase in Unemployment
   While the public deficit soared to 11.2% of GDP in 2009 from a 1.9% surplus in 2007, the unemployment rate shot up from 8.3% to 21.6%.

3. Deterioration of financial sector balance sheets as a result of their high exposure to the Real Estate sector.

Credit to Real Estate developers rose from €78 billion in 2003 to €324 billion in 2009, growing three times faster than total credit to the private sector.

Source: Ministry of Finance
On-going correction of imbalances and strengths of the Spanish economy

- The Economic Policy measures implemented are correcting the accumulated imbalances

- The Spanish economy has significant strengths:

  1. Spain is a sustainable economy
     - The private sector is de-leveraging at a fast speed
     - Public Finances are sustainable
     - A sound financial sector after an aggressive clean-up process and restructuring regulations

  2. Spain is a competitive economy
     - Trade balance in surplus with the Euro zone
     - Good performance of exports
     - Declining Unit Labour Costs are boosting competitiveness
     - Fast Adjustment in the current account deficit
Spain is a sustainable economy
Private sector deleveraging process

Both corporate and household debt have significantly decreased since their peak levels

With the current pace of deleveraging, private sector debt will be below the EC’s reference ratio by the end of this decade

Source: Deutsche Bank

Source: Bank of Spain
Spain is a sustainable economy
Sustainability of Public Finances

A firm commitment to comply with the fiscal consolidation path

General Government Net Lending (+) / Net Borrowing (-) as % of GDP

<table>
<thead>
<tr>
<th></th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Central Goverment and</td>
<td>-5.2</td>
<td>-4.5</td>
<td>-3.8</td>
<td>-2.7</td>
</tr>
<tr>
<td>Social Security</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Autonomous Regions</td>
<td>-3.3</td>
<td>-1.5</td>
<td>-0.7</td>
<td>-0.1</td>
</tr>
<tr>
<td>Local Governments</td>
<td>-0.4</td>
<td>-0.3</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>GENERAL GOVERNMENT</td>
<td>-8.9</td>
<td>-6.3</td>
<td>-4.5</td>
<td>-2.8</td>
</tr>
</tbody>
</table>

The Fiscal Path represents a huge structural adjustment effort, amounting over 7% of GDP in 3 years.

2013 Central Government Budget ensures that the deficit target will be met

- Draft Budget was adopted on September 27th and is currently under Parliamentary discussion
- Draft Budget combines spending cuts and tax rises but is more oriented towards reducing public expenditure
  - 58% of the fiscal adjustment comes from spending cuts.

The 2012 Budgetary Execution figures point out that Spain will meet its fiscal targets
Spain is a sustainable economy
Sustainability of Public Debt

During 2012, Debt/GDP ratio will increase 16 percentage points from 69% to 85.3% of GDP due mostly to one-off measures that do not arise from funding needs.

Besides the Public Deficit, the main elements that explain the increase in Debt/GDP ratio in 2012 are:

- EFSF- Bank recapitalization (€ 30 bn)
- Fund for the Financing of Payments to Suppliers (€ 27 bn)
- Allocation to Spain of the EFSF loans to Portugal, Ireland and Greece
- Others factors

Despite the increase of the Debt to GDP, Gross Public Debt remains below the Eurozone average in 2012 and 2013.

In 2013 most of the increase in the debt to GDP ratio (90.5% of GDP) will stem from funding needs.

Source: European Commission and Ministerio de Hacienda
The rise in interest payments is driven by the stock of existing debt, while the average cost of Spanish debt at issuance is slightly below 2011 and far from historical values.

Source: Secretaría General del Tesoro y Política Financiera.
Financial Sector Reform. Steps

1. **CLEAN-UP OF BANKS BALANCE SHEETS** → February and May 2012: increased coverage of problematic and performing Real estate assets linked to loans to developers
   - Coverage of real estate assets raised from 18% in December 2011 to 45% in December 2012
   - By year end, Provisions and Capital buffers will amount to €137 bn → the Spanish financial system coverage ratios will rank among the highest in the EU

2. **RECAPITALISATION AND RESTRUCTURING** → Recapitalization on the basis of independent evaluations

   - **Initial Steps**
     - Capital needs:
       - IMF FSAP (June): €37bn
       - Top-down exercise by Oliver Wyman and Roland Berger (June): €51-62 bn
       - MoU (July)

   - **Intermediate steps**
     - Bottom-up exercise: Oliver Wyman results
       - Identification of Group 0 and 1 banks

   - **Next Steps**
     - Identification of Group 2 and 3 banks
     - Bank recapitalisation plans October
     - Bank restructuring plans.
       - G1 banks: October
       - G2 banks: November
     - Development of Asset Management Company (AMC)

   - **Effective Recapitalisation**
     - G1 banks: November → funds from Contingency facility
     - G2 & G3 banks: from December 2012 onwards
     - Full transfer of assets to AMC: from December 2012 until mid 2013 for Group 3 banks

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**Group 0**: Banks with no capital shortfall

**Group 1**: Banks under public control (FROB)

**Group 2**: Banks with capital shortfall and no possibility to raise capital privately

**Group 3**: Banks with capital shortfall aiming to raise capital privately
Oliver Wyman bottom-up exercise

- Fully coordinated with an external consultant (BCG), and guided by the European Commission, the ECB, the EBA and the IMF

- Stress test based on the inputs from four independent auditors (Deloitte, PwC, Ernst & Young and KPMG).
  - Test performed with high quality data:
    - Auditor’s input on loan status and restructured exposures
    - Granular deleveraging inputs by entity and asset class
    - Professional Real Estate Appraisers' input on the current value of real estate assets

- Two scenarios considered:
  - Baseline scenario: Hurdle → Core Capital 9%
  - Stressed Scenario: Hurdle → Core Capital 6%

- The assumptions of the Adverse Scenario are stricter than the industry’s average

<table>
<thead>
<tr>
<th>Adverse Scenario. Y-o-Y growth rates</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>Cumulative Variation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real GDP</td>
<td>-4,1</td>
<td>-2,1</td>
<td>-0,3</td>
<td>-6,5</td>
</tr>
<tr>
<td>Unemployment (rate)</td>
<td>25,0</td>
<td>26,8</td>
<td>27,2</td>
<td></td>
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<tr>
<td>DGP Deflator</td>
<td>0,0</td>
<td>-0,7</td>
<td>0,1</td>
<td>-0,6</td>
</tr>
<tr>
<td>Housing Prices</td>
<td>-19,9</td>
<td>-4,5</td>
<td>-2,0</td>
<td>-26,4</td>
</tr>
<tr>
<td>Land Prices</td>
<td>-50,0</td>
<td>-16,0</td>
<td>-6,0</td>
<td>-72,0</td>
</tr>
<tr>
<td>Euribor, 3 months (rate)</td>
<td>1,9</td>
<td>1,8</td>
<td>1,8</td>
<td></td>
</tr>
<tr>
<td>SPGB 10YR</td>
<td>7,4</td>
<td>7,7</td>
<td>7,7</td>
<td></td>
</tr>
<tr>
<td>Credit to Households</td>
<td>-6,8</td>
<td>-6,8</td>
<td>-4,0</td>
<td>-17,6</td>
</tr>
<tr>
<td>Credit to Non-Financial Firms</td>
<td>-6,4</td>
<td>-5,3</td>
<td>-4,0</td>
<td>-15,7</td>
</tr>
<tr>
<td>IBEX</td>
<td>-51,3</td>
<td>-5,0</td>
<td>0,0</td>
<td>-56,3</td>
</tr>
</tbody>
</table>
The Spanish financial sector would face a €270 bn in system-wide projected losses.

<table>
<thead>
<tr>
<th>Capital needs under € 60 bn in the adverse scenario</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>✓ € 59.3 bn without considering mergers and deferred tax assets</td>
<td>€ 59.3 bn</td>
</tr>
<tr>
<td>✓ € 57 bn considering mergers and without considering deferred tax assets</td>
<td>€ 57 bn</td>
</tr>
<tr>
<td>✓ € 53.7 bn considering mergers and deferred tax assets</td>
<td>€ 53.7 bn</td>
</tr>
</tbody>
</table>

![Diagram showing estimated capital needs](image)

**Estimated Capital Needs under the Adverse Scenario**

*(in € bn)*

- Projected losses: €270 bn
- Total provisions: €110 bn
- Asset Protection Schemes: €8 bn
- New Profit generation: €59 bn
- Excess capital buffer*: €36 bn
- Capital deficit (pre-tax): €57 bn
- DTA/Tax effects: €3 bn
- Capital deficit (post-tax): €53.7 bn
Oliver Wyman bottom-up exercise. Results

Adverse Scenario. Core Tier 1: 6%

The Spanish financial sector would face a €270 bn in system-wide projected losses

Capital needs under € 60 bn in the adverse scenario

✓ € 59.3 bn without considering mergers and deferred tax assets
✓ € 57 bn considering mergers and without considering deferred tax assets
✓ € 53.7 bn considering mergers and deferred tax assets

Estimated Capital Needs under the Adverse Scenario

(in € bn)

<table>
<thead>
<tr>
<th>Bank</th>
<th>Capital Needs (in € bn)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Santander</td>
<td>25.3</td>
</tr>
<tr>
<td>Caixabank</td>
<td>11.2</td>
</tr>
<tr>
<td>Sabadell-Cajasur</td>
<td>5.7</td>
</tr>
<tr>
<td>Unicaja-CEISS</td>
<td>2.2</td>
</tr>
<tr>
<td>BMN</td>
<td>0.9</td>
</tr>
<tr>
<td>Banco Valencia</td>
<td>0.4</td>
</tr>
<tr>
<td>Catalunya Banc</td>
<td>-10.8</td>
</tr>
<tr>
<td>BBVA-UNNIM</td>
<td>-24.7</td>
</tr>
<tr>
<td>Kutxabank-Cajasur</td>
<td>-7.2</td>
</tr>
<tr>
<td>Bankinter</td>
<td>-3.5</td>
</tr>
<tr>
<td>Libercaja</td>
<td>-3.2</td>
</tr>
<tr>
<td>Popular-Pastor</td>
<td>-2.2</td>
</tr>
<tr>
<td>NCG Banco</td>
<td>-2.1</td>
</tr>
</tbody>
</table>

\[\sim€54 \text{ bn}^1\]
Oliver Wyman bottom-up exercise. Conclusions

Adverse Scenario. Core Tier 1: 6%

- **Estimated capital needs** of the Spanish Financial System are under €60 bn → well below the €100 bn assistance from the EFSF/ESM

- 7 banks that account for almost around 70% of the Spanish financial system (Santander, BBVA, Caixabank, Kutxabank-Cajasur, Sabadell-CAM, Bankinter, Unicaja-CEISS) have a capital excess of €46 bn.
  - This confirms previous findings from other evaluations

- 86% of all capital shortfalls are concentrated on Banks owned by the FROB (BFA-Bankia, Catalunya Bank, NCG Banco, Banco Valencia) → They stand for 18% of the system

- The **actual capital injection** to the Spanish Financial System will be far less than the estimated capital shortfall → the following items need to be considered:
  - Transfers of assets to the AMC
  - Capital gains from disposal of assets
  - Subordinated Liability Exercises
  - Privately raised capital

- A contingency facility of €30 bn from the EFSF/ESM financial assistance is readily available and shall be used in November to capitalise Banks owned by the FROB
New Framework for Bank Restructuring and Resolution

A new framework for the restructuring and resolution of financial institutions has been adopted

- An essential tool in the crisis management of financial institutions
  - Sets up a comprehensive framework to deal with financial institutions in stressed situations.
  - Reinforces intervention tools at all stages of crisis management:
    1. Early intervention for mild difficulties
    2. Restructuring measures for institutions with temporary troubles that can be solved with public support
    3. Orderly resolution for non-viable institutions

- Early introduction of provisions foreseen in the future European Directive on Bank Recovery and Resolution currently under negotiation at the EU level

- Establishment of an Asset Management Company (AMC)
Spain is a competitive economy.
Trade Balance evolution and Export Performance

- Trade Balance with Eurozone members in surplus since 2010
  - Trade surplus with France, Italy, and Austria among others
  - The trade surplus (goods and services) with the Eurozone has recorded a fivefold increase in the first half of 2012.
  - The trade deficit with Germany has been drastically reduced → in the first half of 2012 it declined by 52% and exports to Germany grew 7.4% y-o-y.

- At a global level: Spain records a non-energy goods surplus and Tourist and Non-tourist services surplus.

- Since 2001, Spanish goods exports have increased by 70%, the same as in Germany. Italian exports have grown by 41% and French exports by 30%.
Spain is a competitive economy
Increased Competitiveness and External Deficit Correction

- Declining Unit Labour Costs are boosting competitiveness
  - Manufacturing labour costs have decreased by more than 12% since their peak in March 2009
  - The non-EU share in total exports has increased to 35% from 28% in 2010

- The financing needs of the Spanish economy are significantly narrowing. From a deficit of 10% of GDP in 2007, the current account is expected to be close to balance in 2013.
  - The primary account balance (excluding foreign debt interest payments) is in surplus since 2011 and is improving further.
Structural Reforms
Increased flexibility and competitiveness of the Spanish Economy

Main structural reforms already implemented

1. Labour Market Reform
2. Financial Sector Reform
3. Retail sector: liberalization of opening hours and elimination of restrictions on sale activities
4. Liberalization of the Housing rental Market
5. Health and Education

A Labour market reform to foster wage moderation and job creation

Main measures adopted:

- Firm-level wage bargaining prevails over national, regional or sector agreements
- Collective dismissals without administrative authorization are allowed for firms posting falling profits for three or more consecutive quarters
- Elimination of procedural wages
- Convergence of dismissals costs with the EU average
  - Unfair dismissal: severance pay of 33 days per year worked up to 24 months
  - Fair dismissal: severance pay of 20 days per year, up to 12 months
- Clarification of objective causes for fair dismissal
- Creation of a new permanent contract directed at SMEs
An ambitious overhaul of the internal market regulation has been approved

- Over 40 laws will be shortly approved in order to transform Spain’s productive tissue
- New reform package goes beyond the European Semester’s Country recommendations

### MEASURES

#### 1. REFORMS TO BOOST EMPLOYMENT

<table>
<thead>
<tr>
<th>Measure</th>
<th>Status</th>
</tr>
</thead>
<tbody>
<tr>
<td>Vocational Training Reform → to foster a more efficient labour market matching</td>
<td>before year end</td>
</tr>
<tr>
<td>Improvement and Increased Efficiency of the Public Employment Services</td>
<td>before year end</td>
</tr>
<tr>
<td>Exhaustive Assessment of Active Labour Market Policies</td>
<td>Q1 2013</td>
</tr>
<tr>
<td>Improved Education and Development of Human Capital</td>
<td>Draft Law approved</td>
</tr>
</tbody>
</table>

#### 2. REFORMS TO ENSURE THE SUSTAINABILITY OF PUBLIC FINANCES

<table>
<thead>
<tr>
<th>Measure</th>
<th>Status</th>
</tr>
</thead>
<tbody>
<tr>
<td>Independent Fiscal Authority</td>
<td>Before year end</td>
</tr>
<tr>
<td>Strict Compliance of the Budget Stability Law</td>
<td>Ongoing</td>
</tr>
<tr>
<td>Guarantee of the Pension System → measures to be proposed to the “Pacto de Toledo”</td>
<td>Before year end</td>
</tr>
<tr>
<td>Streamlining Public Spending and Reform of the Public Sector</td>
<td>Before year end</td>
</tr>
</tbody>
</table>
AN IMPROVED REGULATORY FRAMEWORK FOR BUSINESS & THE PRIVATE SECTOR

3

SINGLE MARKET PROGRAMME → To address the fragmentation of the national market
LIBERALIZATION OF PROFESSIONAL SERVICES → New Law of Professional Services
PLAN ON ENTREPRENEURSHIP AND BUSINESS ENVIRONMENT → Wide array of measures to support entrepreneurs, SMEs and self-employed workers
INTERNATIONALIZATION AGENCY → Centralization of all public export promotion instruments
DEVELOPING SCIENCE AND INNOVATION → Creation of a State Agency for Research

REFORMS TO REINFORCE COMPETITION

4

ENERGY SECTOR → to further advance the liberalisation of the sector
TELECOMMUNICATIONS SECTOR → to facilitate networks and the provision of services
TRANSPORTATION SECTOR → to open up the sector and to foster competitiveness
Strengthening the Economic and Monetary Union

The shortcomings of the institutional architecture of the European Economic and Monetary Union (EMU) are at the root of the doubts concerning the Euro

- Strong fragmentation in Euro Area financial markets → severe market distortions
- According to the IMF: around 200 basis points of the Spanish sovereign spread are due to doubts on the reversibility of the euro → not explained by long term fundamentals

The institutional set-up of the Euro Area needs to be strengthened → a resolute move towards greater banking, economic and fiscal integration

- A credible commitment towards a robust and complete Monetary Union is required, through:
  - a genuine Banking Union (Single Supervisory Mechanism, European Deposit Guarantee Mechanism and a Common Bank Resolution Mechanism)
  - a deeper budgetary integration
  - supported by wide-ranging structural reforms throughout the Euro area
Main features of funding strategy

- Strong commitment with the Public Debt market
  - Rigorous adherence to auction calendar
  - Catering to market demand, at market rates

- 83.4% of medium and long-term issuance already done

- Manageable cost of issuance and debt outstanding, stable duration and average life

- Prudent management of refinancing risk
Funding and Debt Management

Funding Programme for 2012

- The bulk of net issuance carried out through medium- and long-term issuance in order to contain refinancing risk
- Until September 30th the Spanish Treasury has funded 71.7 billion (83.4%) of the total expected amount of medium- and long-term gross issuance of 86 billion euro of the regular issuance programme
- Apart from the regular issuance programme, during September the Treasury has issued €4.5 bn in 6-month T-bills and €4.5 bn in medium- and long-term bonds for the Regional Liquidity Fund (FLA) and the FROB. In October further €5 bn will be issued for the FLA.

<table>
<thead>
<tr>
<th>Tesoro funding (Billion Euro). Excluding Regional Liquidity Fund and Bank Recap</th>
<th>2012 Budgets</th>
<th>2013 Provisional Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1: Funding requirement (=Net Issuance)</td>
<td>36.8</td>
<td>48.0</td>
</tr>
<tr>
<td>2: Redemptions of medium- and long-term bonds</td>
<td>-50.1</td>
<td>-62.3</td>
</tr>
<tr>
<td>3: Net issuance medium- and long-term bonds</td>
<td>35.8</td>
<td>28.1</td>
</tr>
<tr>
<td>4 = 2 + 3: Gross issuance of medium and long-term bonds</td>
<td>85.9</td>
<td>90.4</td>
</tr>
<tr>
<td>5: Net increase in T-Bills</td>
<td>1.0</td>
<td>19.9</td>
</tr>
<tr>
<td>6 = 5 + 3: Net change in outstanding debt</td>
<td>36.8</td>
<td>48.0</td>
</tr>
<tr>
<td>7: Forecast Outstanding Central Government Debt at end of year</td>
<td>628.9</td>
<td>684.8</td>
</tr>
</tbody>
</table>

Source: Ministerio de Economía y Competitividad.

Funding Programme. 2010-2012

(Gross issuance, medium and long-term bonds, in billion Euro, *up to September 30th 2012)

<table>
<thead>
<tr>
<th>Year</th>
<th>2011 Jan Projection</th>
<th>2011 Executed</th>
<th>2012 Apr Projection</th>
<th>2012 Sep Execution*</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011</td>
<td>93.8</td>
<td>95.6</td>
<td>71.7</td>
<td>85.9</td>
</tr>
<tr>
<td>2012</td>
<td>0</td>
<td>25</td>
<td>50</td>
<td>75</td>
</tr>
</tbody>
</table>

Source: Secretaría General del Tesoro y Política Financiera.
Relative stability of non-resident term investment holdings

Source: Secretaría General del Tesoro y Política Financiera.
* As of August 31st 2012.

Source: Secretaría General del Tesoro y Política Financiera.
* As of July 31st 2012.
Funding and Debt Management
Main features of the execution for 2012

- Despite volatility in European Public Debt markets, average cost at issuance and average cost of debt outstanding remain subdued
- Average life of the debt portfolio has fluctuated and declined in the last year

**Cost of Debt Outstanding and Cost at Issuance**

(As of September 30th in percent)

**Duration and Average Life**

(As of September 30th, in years)

Source: Secretaría General del Tesoro y Política Financiera.
Redemption dates of medium- and long-term bonds (principal and coupons) match the biggest inflows of tax revenues

Excess liquidity is lent in the money market each month through repo auctions

Liquidity lines with banks provide an additional buffer

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**Monthly Maturity Structure in 2012 as of September 30th 2012 (in billion Euros)**

<table>
<thead>
<tr>
<th>Month</th>
<th>Letras</th>
<th>Bonos</th>
<th>Obligaciones</th>
<th>Foreign Currency &amp; Other</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jan</td>
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<td>Feb</td>
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<td>Mar</td>
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<td>May</td>
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<td>Nov</td>
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<tr>
<td>Dec</td>
<td></td>
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</tr>
</tbody>
</table>

**Administrative Distribution of Tax Collection**

- **Personal Income Tax**
- **Corporate Income Tax**
- **VAT**
- **Excise Duties & Other**

**Degree of concentration of tax collection**

Source: Secretaria General del Tesoro y Politica Financiera.
Funding and Debt Management
Risk and Refinancing Measures

- Redemptions of Euro-denominated debt remain well in line with those of peers

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

**Relative Redemptions**
*(% of estimated 2012 GDP. October 2012 to September 2013)*

- **2012**: Italy, €341.2 bn; Belgium, €68.0 bn; France, €301.3 bn; Spain, €138.1 bn; Germany, €212.0 bn
- **2013**: Italy, 21.5%; Belgium, 18.0%; France, 14.7%; Spain, 13.1%; Germany, 8.1%

*Source: Secretaría General del Tesoro y Política Financiera. For Spain, and Bloomberg for other countries.*
APPENDIX

ADDITIONAL INFORMATION
Macroeconomic outlook 2012-2015

- Negative growth in National Demand to be partially offset by export-led growth in 2012 and 2013
- Private consumption and investment to resume growth in 2014

<table>
<thead>
<tr>
<th>Macroeconomic scenario</th>
<th>2011</th>
<th>2012 (f)</th>
<th>2012-Q1</th>
<th>2012-Q2</th>
<th>2013 (f)</th>
<th>2014 (f)</th>
<th>2015 (f)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Private consumption</td>
<td>-1.0</td>
<td>-1.5</td>
<td>-1.4</td>
<td>-2.2</td>
<td>-1.4</td>
<td>1.0</td>
<td>1.3</td>
</tr>
<tr>
<td>Government consumption</td>
<td>-0.5</td>
<td>-4.8</td>
<td>-3.6</td>
<td>-3.0</td>
<td>-8.2</td>
<td>-6.4</td>
<td>-3.8</td>
</tr>
<tr>
<td>Gross Fixed Capital Formation</td>
<td>-5.5</td>
<td>-9.8</td>
<td>-2.7</td>
<td>-3.0</td>
<td>-2.0</td>
<td>1.4</td>
<td>3.1</td>
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<tr>
<td>National Demand*</td>
<td>-1.9</td>
<td>-4.0</td>
<td>-3.2</td>
<td>-3.9</td>
<td>-2.8</td>
<td>-0.3</td>
<td>0.8</td>
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<tr>
<td>Exports of goods and services</td>
<td>7.6</td>
<td>1.6</td>
<td>2.8</td>
<td>3.3</td>
<td>6.0</td>
<td>7.1</td>
<td>7.7</td>
</tr>
<tr>
<td>Imports of goods and services</td>
<td>-0.9</td>
<td>-6.7</td>
<td>-5.9</td>
<td>-5.4</td>
<td>-1.5</td>
<td>3.3</td>
<td>5.6</td>
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<tr>
<td>External demand*</td>
<td>2.3</td>
<td>2.5</td>
<td>2.6</td>
<td>2.6</td>
<td>2.3</td>
<td>1.5</td>
<td>1.1</td>
</tr>
<tr>
<td>GDP</td>
<td>0.4</td>
<td>-1.5</td>
<td>-0.6</td>
<td>-1.3</td>
<td>-0.5</td>
<td>1.2</td>
<td>1.9</td>
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<table>
<thead>
<tr>
<th>Other macroeconomic variables</th>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Unemployment rate (in %)</td>
<td>21.6</td>
<td>24.6</td>
<td>24.4</td>
<td>24.6</td>
<td>24.3</td>
<td>23.3</td>
<td>21.8</td>
</tr>
<tr>
<td>Unit Labour costs</td>
<td>-1.5</td>
<td>-3.5</td>
<td>-1.5</td>
<td>-2.1</td>
<td>0.8</td>
<td>-0.5</td>
<td>-0.5</td>
</tr>
<tr>
<td>Net lending(+) / borrowing(-) with RoW (% of GDP)</td>
<td>-3.2</td>
<td>-1.5</td>
<td>--</td>
<td>--</td>
<td>0.5</td>
<td>1.5</td>
<td>2.0</td>
</tr>
</tbody>
</table>

Source: National Statistics Institute and Ministerio de Economía y Competitividad.

* Contributions to GDP growth.
New fiscal framework

- The public expenditure review establishes a new institutional and regulatory framework for Public Administrations

**Budgetary and Financial Stability Law**
- Fiscal discipline at all levels of the Administration
- Early-warning system, enforcement and sanction procedures
- Transparency: monthly and quarterly reporting on budget execution/submission of budgetary guidelines previous to the approval of regional budgets

**Draft Law for Transparency in the Public Administrations**
- Increases the provision of information to citizens
- Good Governance Code with statutory principles of action for all Public Administrations
- Individually sanctions public employees and senior officials that do not administer public funds properly
Budgetary and Financial Stability Law (I)

- Implements Article 135 of the Spanish Constitution
- Strengthens Spain's commitment to the EU by incorporating EU regulation requirements and allowing these to be continuously and automatically adapted
- Budgetary and financial sustainability are the guiding principles of all public administrations

Approved by Parliament 25/04/2012

**PREVENTIVE AND CORRECTIVE MECHANISMS**

- Structural Balance
  - Structural balance or surplus
- Public Debt
  - Volume of EDP Public debt < 60%
- Expenditure Rule
  - Computable expenditure below medium-term GDP growth reference rate

Preventive Mechanisms
- Automatic Preventive Mechanisms
  - Warning in case of risk of non-compliance
Corrective and enforcement mechanisms
- Automatic corrective measures
- Economic and financial plans
- Enforcement measures
The law is directly applicable to the rebalancing plans presented for 2012 by the Regional Governments.

If these plans fail to be approved, the enforcement mechanisms set in the law will be used:

- Approval of non-availability agreement within 15 days and possible immediate exercise of regulatory authority by the Central Government on transferred taxes.
- If non-availability agreement is not adopted or considered insufficient: expert delegation is sent to the region, proposal of coercive measures.
- Creation of a deposit at the Bank of Spain → fine in 3 months.
The Regional Liquidity Mechanism (FLA)

- Mechanism designed to enable the centralisation of public debt issuance in Spain, to provide liquidity to Autonomous Regions, and to ensure their fiscal and financial sustainability

- The mechanism is based on the following principles:
  - Participation is voluntary. Autonomous regions that wish to participate in 2012 must make a formal request to the Central Government
  - The Central Government will add the funding needs of participating regions to its funding programme
  - Participating Autonomous Communities will be subject to strict fiscal conditionality

- The liquidity mechanism will fund up to €18 bn in 2012:
  - Funding from Loterías y Apuestas del Estado for €6 bn
  - Funding from the banking sector for €8 bn
  - Transfers from the Kingdom of Spain to the Regional Liquidity Mechanism
Fund for the Financing of Payments to Suppliers (FFPP)

- In the last few years, Regional & Local Administrations have been accumulating arrears owed to suppliers (~€35bn), generating liquidity problems to SMEs
- The FFPP has been established for €30bn (Max up to €35bn) to:
  - Provide liquidity to suppliers by immediately regularising arrears
  - Provide a financing vehicle to Regional and Local Governments for the regularisation of arrears
  - Force the fiscal adjustment in Regional and Local Administrations
- FFPP support subject to strict fiscal conditionality
- Payments to suppliers has begun in May in the case of Local Administrations (€9.3 bn). The tranche for Regional Administrations has been disbursed in June (€17.5 bn). Estimated economic impact: 0.8%-0.5% of GDP

Other Accounts Payable. Consolidated, 2011 (In % of GDP)

Source: Bank of Spain, Eurostat.
The labour market reform: complete overhaul of the regulatory framework

### MAIN OBJECTIVES

<table>
<thead>
<tr>
<th>Improving efficiency and reduce labour market duality</th>
<th>Creating effective mechanisms for internal flexibility; adjusting internal wage bargaining, reform the collective bargaining system</th>
<th>Enhancing young workers’ employability</th>
<th>Incentivising permanent contracts</th>
</tr>
</thead>
<tbody>
<tr>
<td>A) Reduction of dismissal costs</td>
<td>A) Firm-level wage bargaining prevails over national, regional or sector agreements</td>
<td>A) Temporary Employment Agencies authorised to act as private agencies</td>
<td>A) New types of contracts</td>
</tr>
<tr>
<td>A.1) Clarification of objective causes for fair dismissal</td>
<td></td>
<td></td>
<td>A.1) Permanent contract</td>
</tr>
<tr>
<td>A.2) Unfair dismissal: severance pay 45 days up to 42 months to 33 days per year worked up to 24 months</td>
<td></td>
<td></td>
<td>directed at SMEs with 50 or fewer workers and self employed</td>
</tr>
<tr>
<td>A.3) Fair dismissal: severance pay of 20 days per year, up to 12 months</td>
<td></td>
<td></td>
<td>A.2) Part-time contract</td>
</tr>
<tr>
<td>A.4) Elimination of “procedural wages”</td>
<td></td>
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<td></td>
</tr>
<tr>
<td>B) Economic causes for fair dismissal: 3 or more consecutive quarters of falling profits</td>
<td>B) Extinguished collective agreements limited to 2 years</td>
<td>B) Improved professional training; individual right to professional training</td>
<td>B) New bonuses for hiring of young workers and long-term unemployed and for conversion of temporary contracts</td>
</tr>
<tr>
<td>C) Public Administrations allowed to dismiss based on objective causes</td>
<td>C) Enhancing adaptation to economic stance via: C.1) Functional mobility of workers</td>
<td>C) Internship contract for workers under 30</td>
<td>C) Prohibition to chain temporary contracts for more than 24 months</td>
</tr>
<tr>
<td></td>
<td>C.2) Working-time reduction</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>C.3) Elimination of red-tape for reduction of hours worked</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Ministerio de Economía y Competitividad.
The labour market reform: estimated economic impact and results

Reduction of firing cost for permanent contracts
- Shrinking the gap between permanent and temporary contracts’ firing costs
- Reduction of the rate of temporary employment
- Lower turnover rates in the labour market

Improvement of internal flexibility mechanisms and the reform of collective bargaining
- Modification of the bargaining process between firms and workers
- Reduction of workers’ bargaining power in wage negotiations
- Easier adaptation of firms to technological innovations

Improvement the efficiency of the matching process

Long-term impact: increase in potential GDP of 4.5% and a rise in the structural rate of employment of 3.7%

Labour Market Reform → leading to wage moderation: latest results
- Contracts with indexation clauses have fallen to 47.1% in August 2012 from 67.3% in 2011
- Average wage increase in new contracts → 0.87% in first semester
- Overall Labour cost increase in Q2 2012 → 0%
- Unit Labour Costs in Q2 2012 → -2.1%