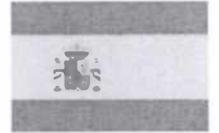




***Update on Policy measures towards a
sustained and balanced growth path***

September 2011

3



Highlights

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 during the last 2 years tackling the underlying problems? Existing evidence on fiscal consolidation, financial system reform, labour market reform, business environment says so

Still some existing challenges have fostered new policies demonstrating the absence of reform fatigue and willingness to further underpin fiscal sustainability and labour market reforms to foster growth

- Can Spain grow? Spain has a diversified and competitive economy with enough resources to enhance growth in the future



- **Reform strategy: fiscal, financial and factor markets**
- **Structural and economic rebalancing**
- **Funding and Debt Management**



Fiscal consolidation (I)

Objectives – regardless of macroeconomic performance

- Short-term: fiscal target of 6% deficit in 2011
- Establishing a more transparent framework that enables a better control
- Ensuring long-term fiscal stability

Instruments

- On-going commitment to deficit reduction
- Constitutional change: Principle of budget stability limiting structural deficit and debt
- New spending rule: public spending linked to economic growth
- Pension reform: greater relationship between years of contribution and pension, incorporating a sustainability factor into the system

Parliamentary approval
expected on September

Approved 14/07/2011

Approved 21/07/2011

General Government commitments by unit (% of GDP)							
	2009	2010		2011	2012	2013	2014
		Commitment	Execution				
General Government Budget Balance	-11.1	-9.3	-9.2	-6.0	-4.4	-3.0	-2.1
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
General Government Debt over GDP	53.3	62.8	60.1	67.3	68.5	69.3	68.9

Source: *Stability Programme Update 2011-2014*.

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



Fiscal consolidation (II)

The Central Government up to July 2011 (EDP) delivers on its commitment

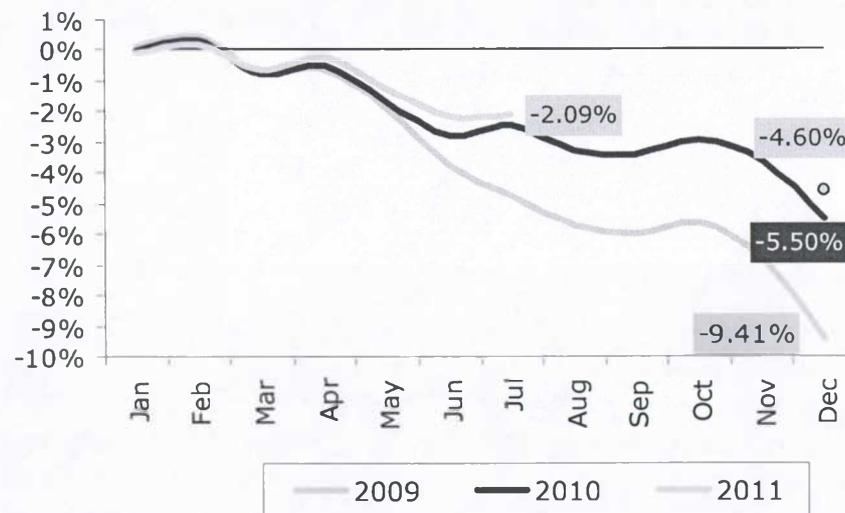
- The cumulative deficit €22.7 billion (-11.8 % yoy)

Additional measures to ensure the delivery of the commitments amounting 2,900 M€ in 2011 and 2,800 M€ in 2012 and 2013 :

- Rescheduling of annual withholding corporate tax payments from large companies
- Redefinition of the procedure by which physicians prescribe publicly financed drugs

Deficit(-)/Surplus(+) of the Central Government and Autonomous institutions (EDP) (% of GDP)

Approved 19/08/2011



Source: IGAE. Net of internal transfers. Target of Central Government for 2011 (-4.8%) adds a surplus of 0.2 from Autonomous institutions as in 2010

Fiscal consolidation (III)

Autonomous Communities

- **Execution:** Q1-2011 data revealed a deficit of 0.46%, with some regions above their targets
- **Monitoring:** Regions require authorisation of debt issuance depending on compliance with the previous year's target and the presentation of a rebalancing plan: authorisation for new issuance extended in three stages conditional on compliance with targets

Council agreements
27/07/2011

- **Ongoing Measures:**
 - Only two rebalancing plans (Catalonia and Castilla la Mancha) are still under review (no authorization of new issuance)
 - Homogeneous reporting of approved regional rebalancing plans
 - Future reporting of budget execution on National Account basis
 - Approval of expenditure rules consistent with the one approved on July 1st for the Central Government and local entities.
 - Constitutional change to limit structural deficit



Financial sector reform (I)

Restructuring:

- Improvement in operational efficiency: 10.4% reduction in branches and 8% reduction in staff since the peak in 2008
- The number of savings banks has decreased from 45 to 15 in less than two years

Corporate governance:

- More than 90% of the assets managed by savings banks have been transferred to commercial banks
- Governance structure improved by means of a Law imposing similar requirements to those of listed companies in terms of corporate governance and eligibility of executive officers based on professional experience

Transparency:

- 93% of the financial sector in July 2011 stress tests.
 - 5 institutions below 5% of CORE TIER 1
 - No Spanish institution requires additional capital on top of the existing commitments as they count on enough paid-up mitigating instruments
- Quarterly reporting on exposure and impaired assets (situation related to construction, real estate and liquidity) since January 2011

Financial sector reform (II)

Solvency:

- **February 2011:** solvency requirements increased to 8%/10%
- **March 2011:** the Bank of Spain identified capital requirements to reach these new thresholds in 13 institutions which amounted to around €17 billion. Recapitalisation plans underway (some count on private funds)
- **July 2011:** four banks and two savings banks had already met their capital needs (€4.5b) through private funds. In addition one saving bank has done so through public funds (€2.8b).
- Three savings banks already listed (accounting for 50% savings banks' assets) raised € 5.2b on capital
- **September 2011:** end of capitalisation through private investors or the FROB, which is committed temporarily to satisfy capital needs at market prices

	Capital	Capital ratio required	Capital needs (C mn)	Recapitalisation alternative	Status
Bankinter	2,144	8.0	333	Instruments qualified as capital	√
Bankpyme	24	8.0	8	Undetaken to increase of capital	Pending
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	2,062	10.0	463	Integration with another institution	Pending
Catalunya-Caixa	3,148	10.0	1,718	FROB	Pending
Grupo BMN	3,343	10.0	637	Private Investors	Pending
Novacaixagalicia	2,851	10.0	2,622	FROB	Pending
Unimm	1,150	10.0	568	FROB	Pending
CAM		10.0	2,800	FROB	√
Effibank		10.0	519	Various capitalisation alternatives	Pending

Source: *Bank of Spain.*



Labour market reform (I)

Hiring:

Approved 19/09/2010

- Promotion of “Contrato de Fomento”: improved definition of causes of fair dismissal
- Lower severance costs for employers at the moment of dismissal
- “German Model” for reduced work schedule: incentivises working-day reduction instead of dismissal or suspension.
- Internal flexibility: facilitates opting out from higher-level collective agreements if the company is under economic stress.

- Training contract for youngsters
- Elimination for next 2 years any limitation to roll over temporary contracts

Approved 26/08/2011

Collective bargaining:

Approved 22/06/2011

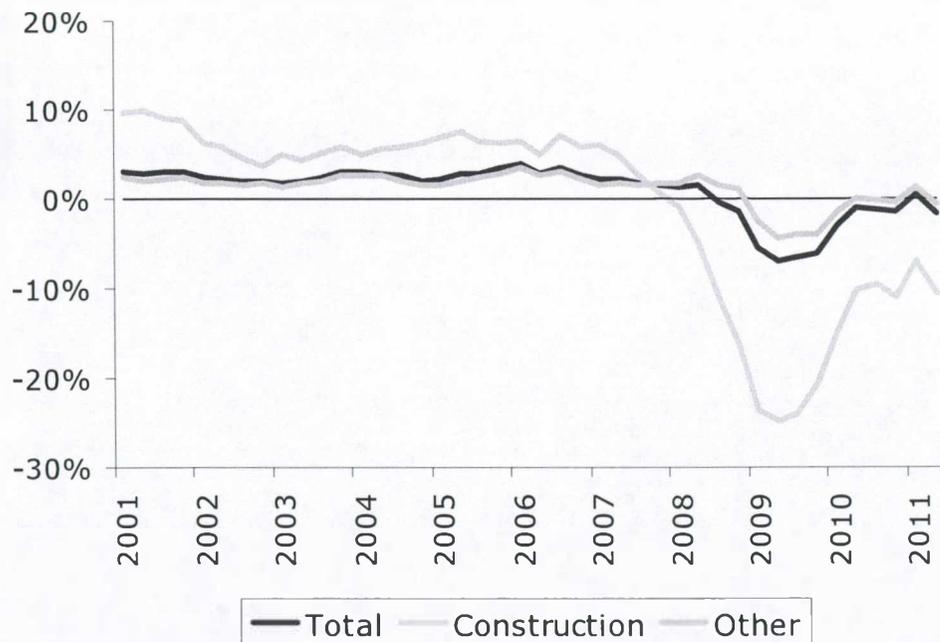
- Incentives for firm-level collective agreements
- Incentives for renegotiating new collective agreements before the expiration of the previous agreement



Labour market reform (II)

- Measures to reduce the Spanish traditional high responsiveness of employment to negative activity shocks
- Recent data suggests policies go in the right direction of facilitating other adjustment different than firing (short time working adjustments and firm wage flexibility)

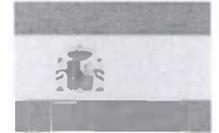
Growth in hours worked by sector
(y-o-y growth rate)



Some data on labour market reforms

Hiring and dismissals (Year-on-year growth rates)		Pre-reform period			Post-reform period		
		May	June	July	Avg rest 2010	Avg 2011	
Dismissals (% over firings)	Objective	16.7	17.2	18.5	20.5	23.9	
	Disciplinary	66.6	67.1	65.7	65.1	60.6	
	Other*	16.8	15.7	15.8	14.4	15.4	
Collective restructuring processes (%)	Other	96.0	97.4	90.5	75.2	75.2	
	German model	4.0	2.6	9.5	24.8	24.8	
Wage developments		2009	2010Q1	2010Q2	2010Q3	2010Q4	2011Q1
	Collective agreements**	2.7	1.5	1.3	1.3	1.3	3.0
	Real wage	3.5	0.9	0.2	-1.8	-2.5	-2.5
	Real labour cost	3.8	0.0	-0.4	-2.2	-2.8	-2.7
	Modification collective agreements (% workers with agreement)				8%		

Source: INE.



Labour market reform (III)

Still unemployment rate is at a high level (20.9%) and the challenge is to reallocate 4% of the labour force that has lost their job related to construction

Active labour market policies should enhance the reallocation:

Approved 11/02/2011

- Incentives for hiring young people on a part-time basis through reductions in social security contributions
- Personalised career advice 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



Product market reforms

SMEs:

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

- Business angels: Exemptions on capital gains for entrepreneurial projects up to €25,000
- Taxation: Reduction of the corporate tax rate for SMEs, 20%-25% depending on their size.
- Liquidity: Payments to suppliers by municipalities have been facilitated. An ICO line has been set up to pay suppliers directly, with the guarantee provided by local entities' future revenues.

Enterprise incorporation: maximum time limit of five days for more than 80% of companies

Bankruptcy Law: facilitates the viability of companies undergoing difficulties through agreements with creditors

Extension of the free amortisation tax scheme for new investments

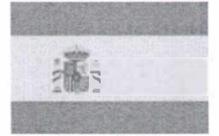
VAT for housing purchase reduced temporarily to 4% from 8%

Approved 23/08/2011



Sector restructuring and Privatisation underway

Airports	Lotteries	Telecommunications
<ul style="list-style-type: none"> ● Separation of airport operation and traffic control <p><i>(Completed in February 2011)</i></p>	<ul style="list-style-type: none"> ● New gambling law <ul style="list-style-type: none"> ▪ Separation of regulation and operation ▪ Regulation of on-line gambling <p><i>(Approved in May 2011)</i></p>	<ul style="list-style-type: none"> ● Introduction of technological neutrality in the usage of spectrum ● Reallocation of the TDT extra-spectrum to telephone services
<ul style="list-style-type: none"> ● Major airports concessioned to private operators <p style="text-align: center;">November 2011</p>	<ul style="list-style-type: none"> ● Privatisation of 30% of the National Lottery <p style="text-align: center;">November 2011</p>	<ul style="list-style-type: none"> ● Spectrum auction <p style="text-align: center;">July 2011</p>
<ul style="list-style-type: none"> ● Privatisation of up to 49% of the National Airport System <p style="text-align: center;">1st quarter 2012</p>		
<p>Expected revenues (in € bn):</p> <p style="text-align: center;">3-4</p>	<p>Expected revenues (in € bn):</p> <p style="text-align: center;">7-9</p>	<p>Expected revenues (in € bn):</p> <p style="text-align: center;">1.8-2.0</p>



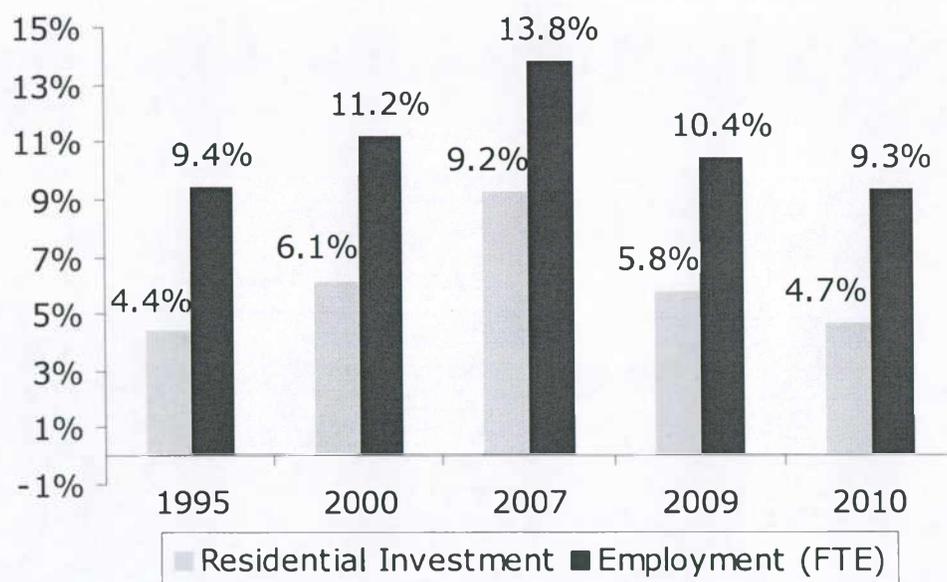
- **Reform strategy: fiscal, financial and factor markets**
- **Structural and economic rebalancing**
- **Funding and Debt Management**

Rapid downsizing of the residential construction sector

- Without the adjustment of construction the Spanish economy grew 1.9% y-o-y in 2011.
- Residential investment accounted for 4.4% of GDP in 1995 and it increased to 9.3% by 2006. In 2011 this ratio is already below the 1995 level of 4.4%
- Stock of unsold houses (estimated at 725,000 in 2010) will continue to shrink in 2011

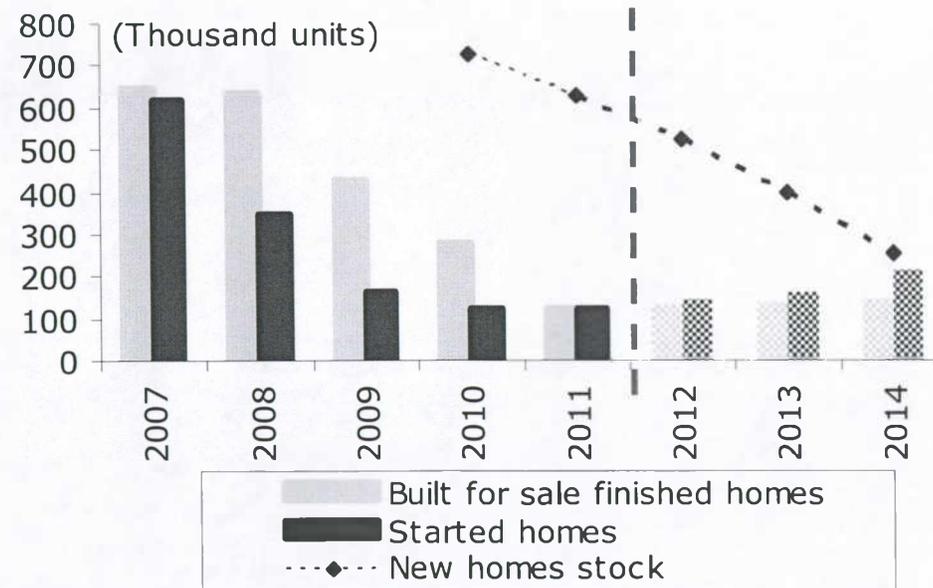
Relative size of the construction sector

(employment over total employment and residential investment over GDP)



Source: *INE*.

Housing: units started and finished



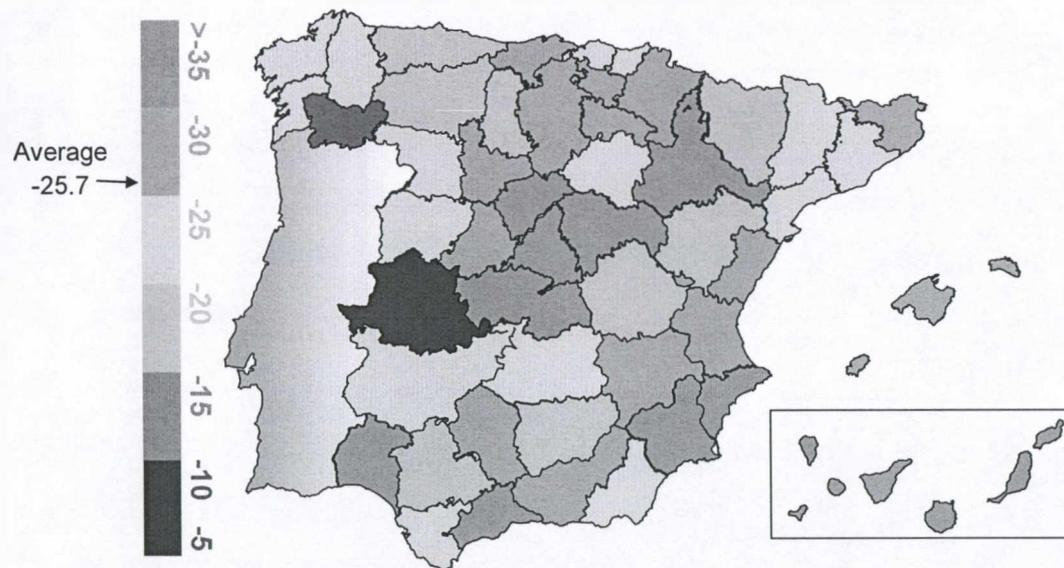
Source: *Ministerio de Economía y Hacienda*.

Housing stock is shrinking and prices are adjusting

- A gradual reduction in the stock of unsold houses and trend housing demand (approx. 350.000 units), will normalise the sector's macroeconomic impact
- The adjustment in housing prices is more intense in the Mediterranean coastline as well as in Madrid and its surroundings

Real price adjustment of used houses per Province

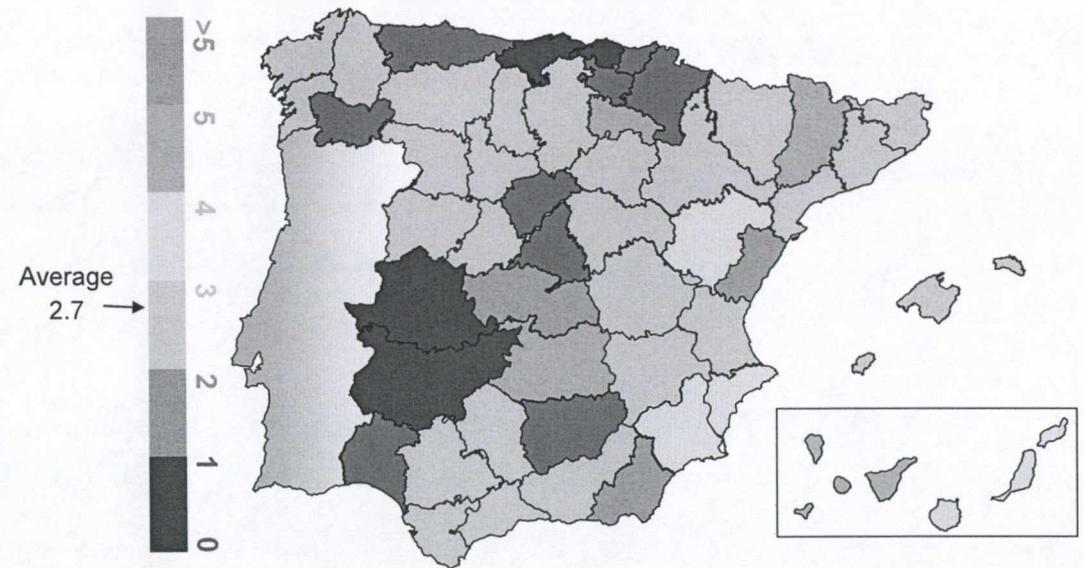
(From peak in each Province to 2011-Q2 in percent)



Sources: *Ministerio de Fomento.*

Unoccupied housing stock per Province

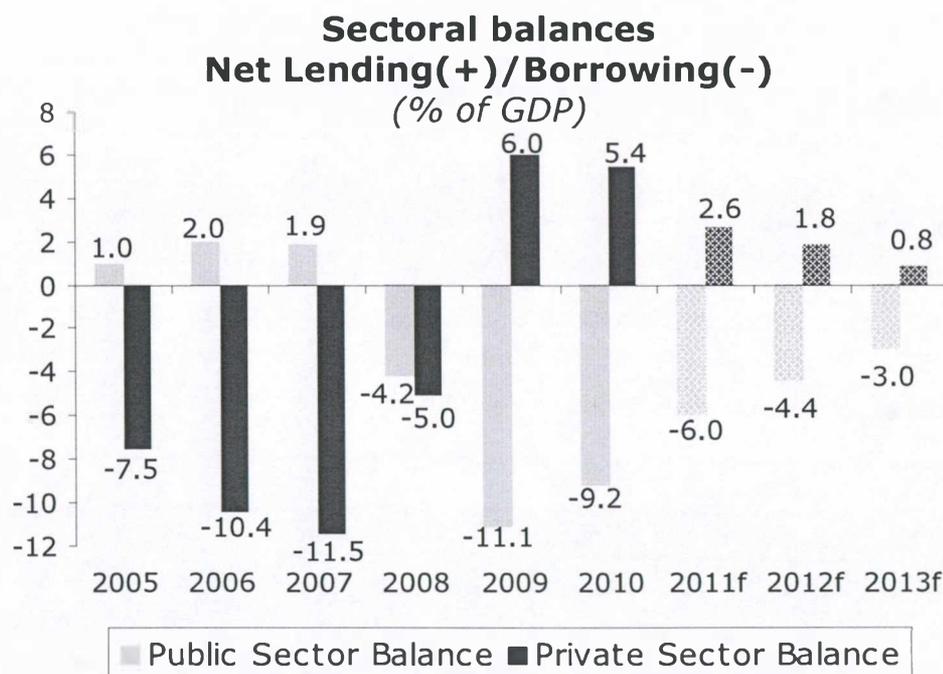
(2010, in percent of total stock in each Province)



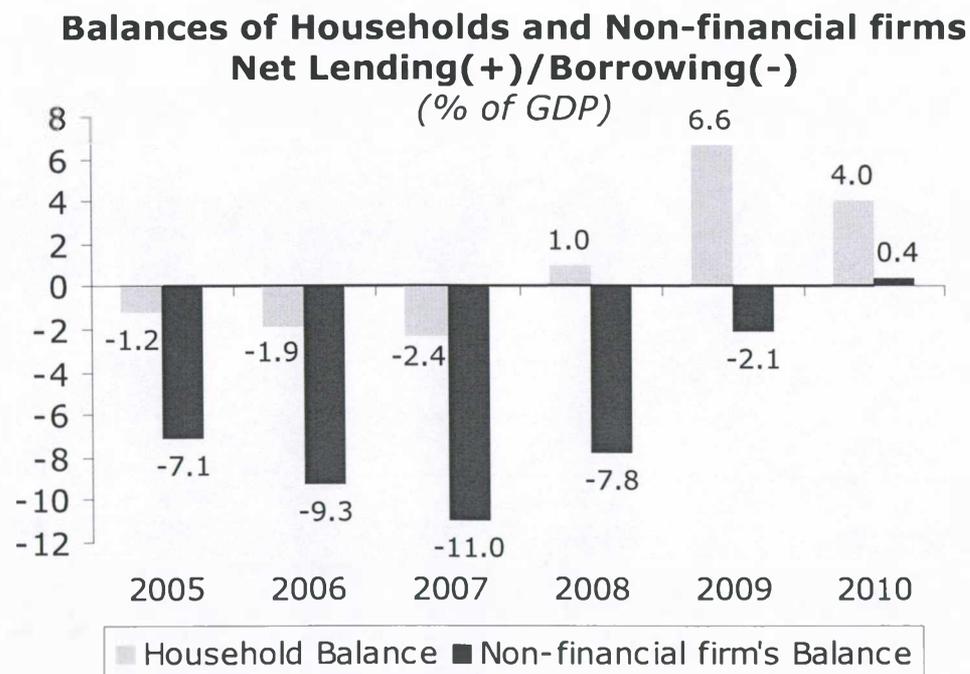
Source: *Ministerio de Fomento.*

Intense adjustment of 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 growth will gradually approach nominal GDP growth



Source: INE and Ministerio de Economía y Hacienda.



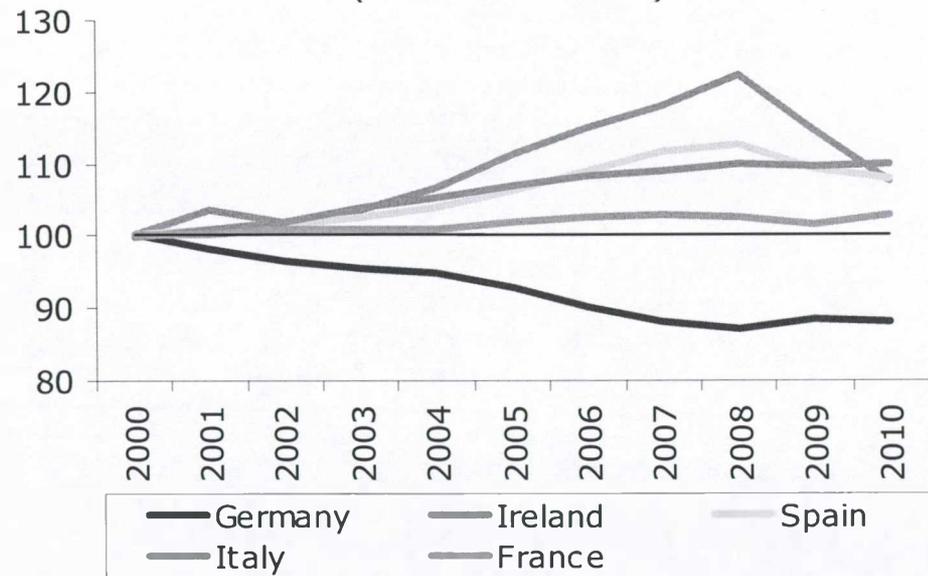
Source: INE.



Recent trends in price competitiveness...

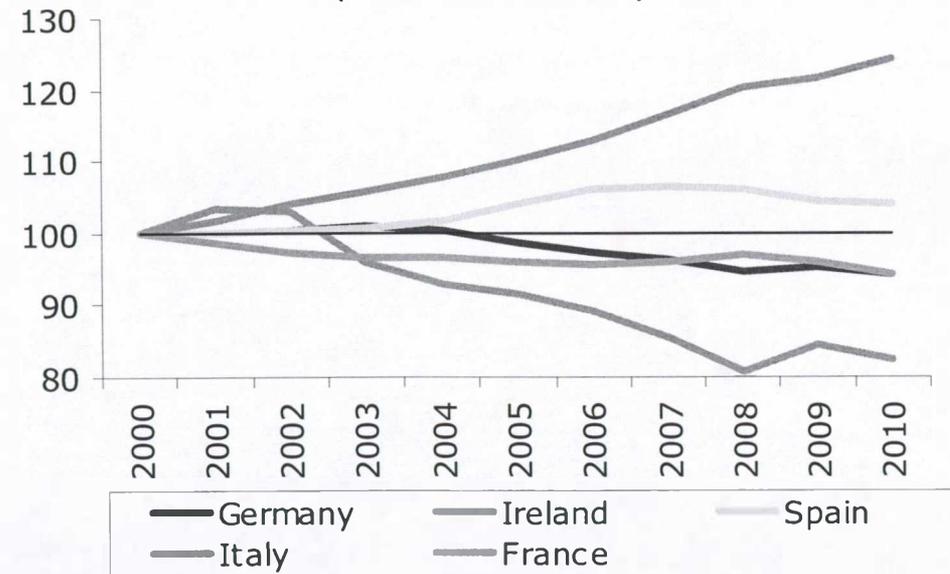
- Between 2000 and 2008, Spain faced an increase in labour costs relative to its European peers
- Price competitiveness has been improving due to the rebalancing and structural adjustment of the Spanish economy

ULC Indexes relative to the Euro Area
(Index 2000=100)



Source: Eurostat.

Export price indexes relative to the Euro Area
(Index 2000=100)

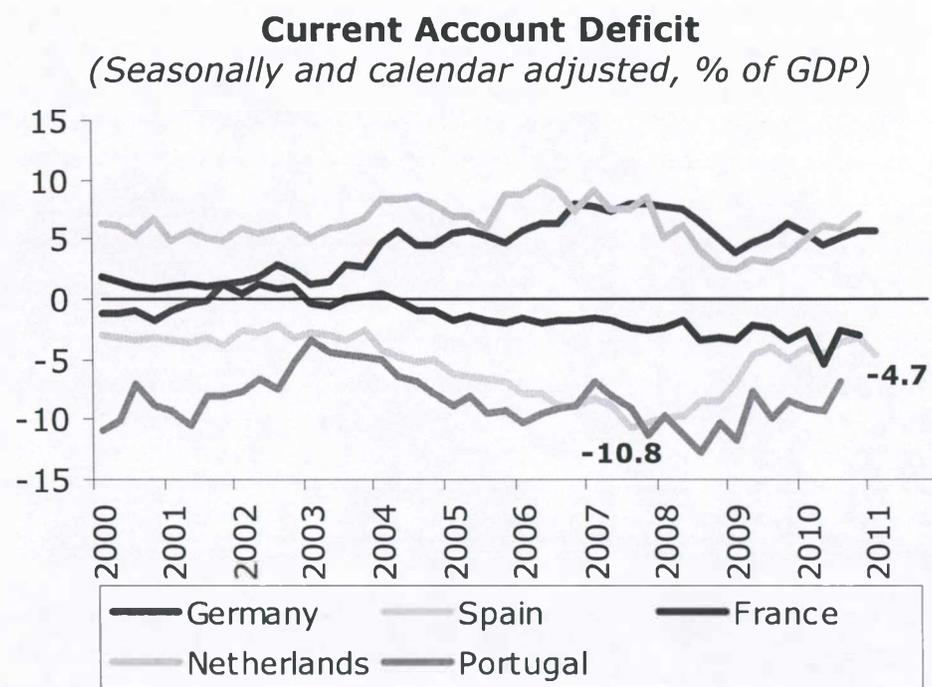


Source: Eurostat.

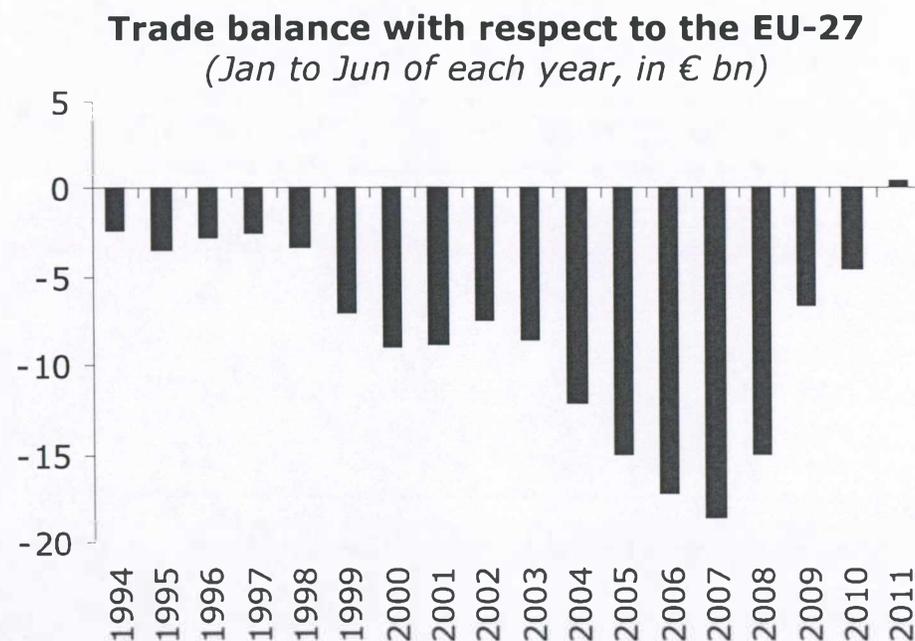


...are bolstering exports...

- 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 export performance. Exports are reacting to the downward pressure on domestic prices and labour cost moderation



Source: *Eurostat*.



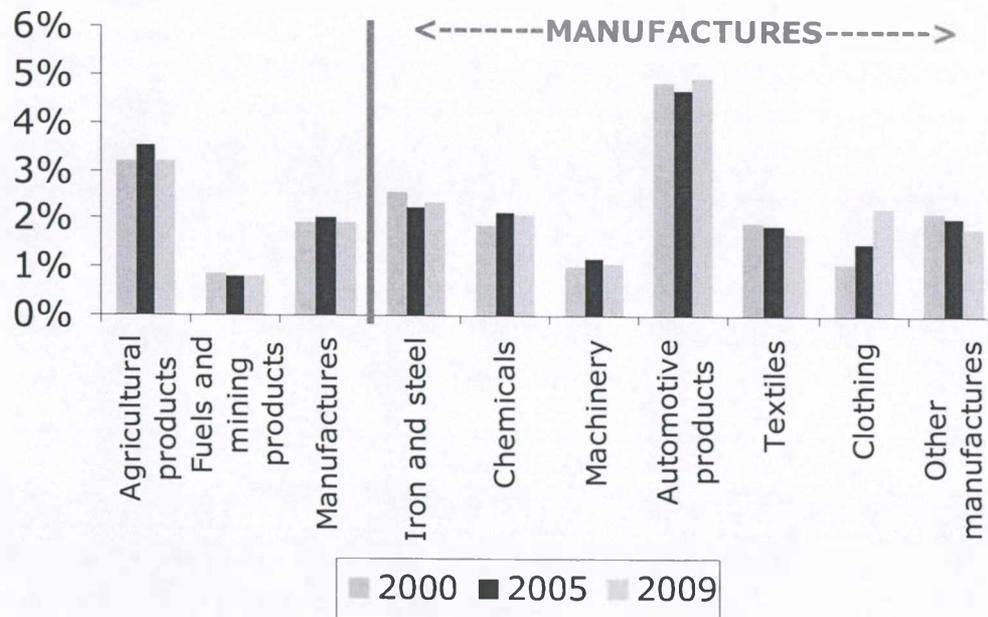
Source: *Ministerio de Economía y Hacienda*.



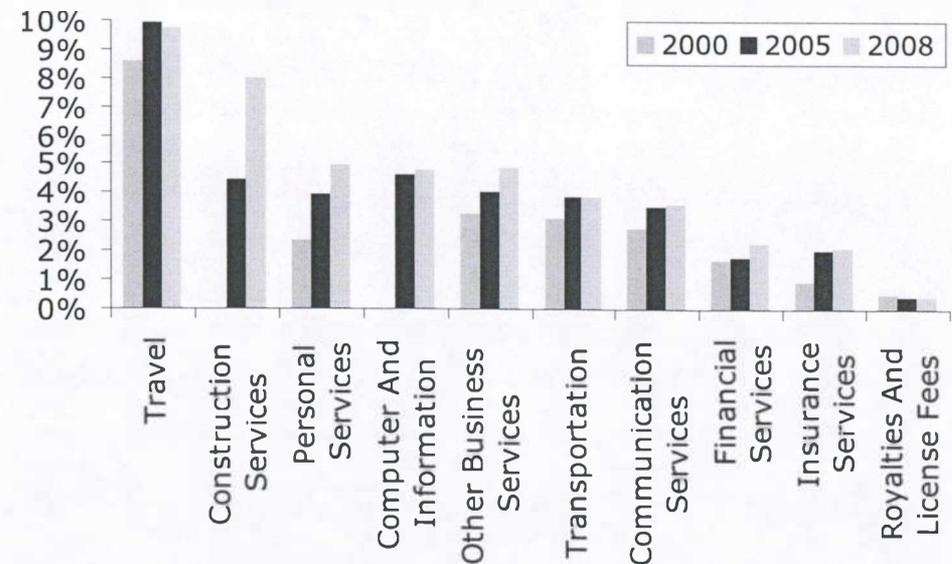
Spanish firms are competitive in a variety of sectors

- Resilience of market share in world merchandise and of service exports other than transportation and tourism-related services
- 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

Share in world merchandise exports by product



Share in world services exports by product



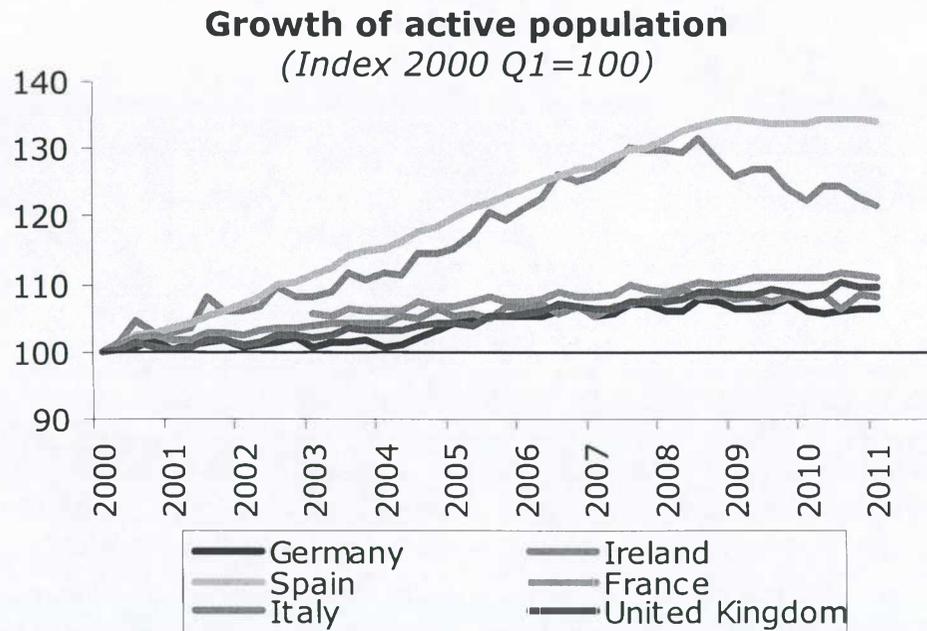
Source: *World Trade Organisation.*

Source: *OECD.*



While potential employment remains high

- During the last decade Spain has increased its labour potential enormously
 - Active population has raised significantly
 - Educational attainment of the labour force has also increased significantly
- Unemployment developments are not a perfect signal of labour capacity utilization due to differences in the incidence of part-time and retirement and education transitions.
 - The usage of the labour potential has decreased during the crisis but remains close to EU countries



Changes in unemployment and labour potential
(Quarterly hours worked/potential hours of pop 15-64)

Unemployment and labour utilization				
	Unemployment	Change wrt 2003	Labour utilization	Change wrt 2003
Germany	6.8%	-3.1%	51.7%	2.4%
Italy	8.7%	-0.5%	52.9%	-1.5%
France	9.6%	1.0%	46.4%	-0.7%
Ireland	14.2%	9.5%	52.3%	-8.0%
Spain	21.4%	9.4%	48.3%	-2.5%

A balanced and sustained growth path for the future

- The combination of structural reforms and the correction of macroeconomic imbalances with the existence of a competitive body of firms and high labour potential will sustain a balanced growth path in the future
- Recent macroeconomic developments show the structural change in the economy
- Despite lower growth for 2011, projections for Spain in the medium-run are in line or above those for the Euro Area

Macroeconomic developments and forecasts

Macroeconomic evolution (Growth rates, volume measures)	year-on-year		quarter-on-quarter 2011	
	2010	2011 (f)	Q1	Q2
	Final Consumption Expenditure	0.7	0.4	0.7
- Private consumption	1.2	0.9	-0.1	0.6
- Public Consumption	-0.7	-1.3	2.9	-2.4
Gross Fixed Capital Formation	-7.6	-1.3	-1.6	-1.0
- Equipment	1.8	3.2	0.0	0.3
- Construction	-11.1	-4.7	-2.8	-0.9
- Other products	-8.2		-0.6	-3.5
National demand*	-1.2	0.0		
Exports of goods and services	10.3	8.3	5.8	-1.9
Imports of goods and services	5.4	3.0	5.0	-3.7
External demand*	1.1	1.3		
GDP	-0.1	1.3	0.4	0.2

Source: INE.

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

Sources: *Ministerio de Economía y Hacienda.*

* Potential output.



- **Reform strategy: fiscal, financial and factor markets**
- **Structural and economic rebalancing**
- **Funding and Debt Management**

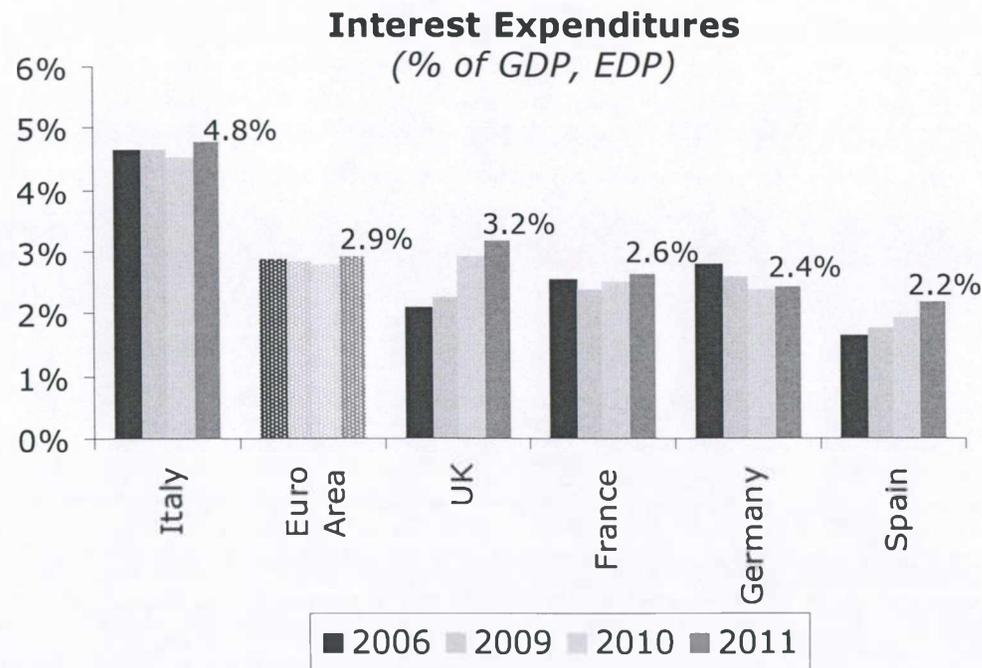
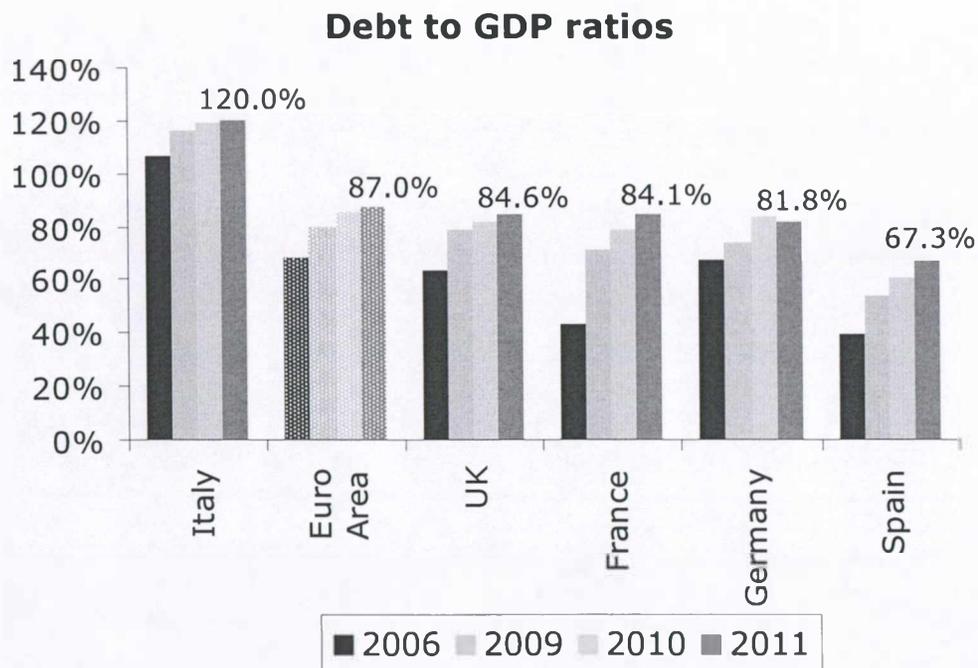
Highlights of debt management

- Substantial reduction of net issuance
- Refinancing risk contained through longer average portfolio maturity
- 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.



The funding programme in 2011 (I)

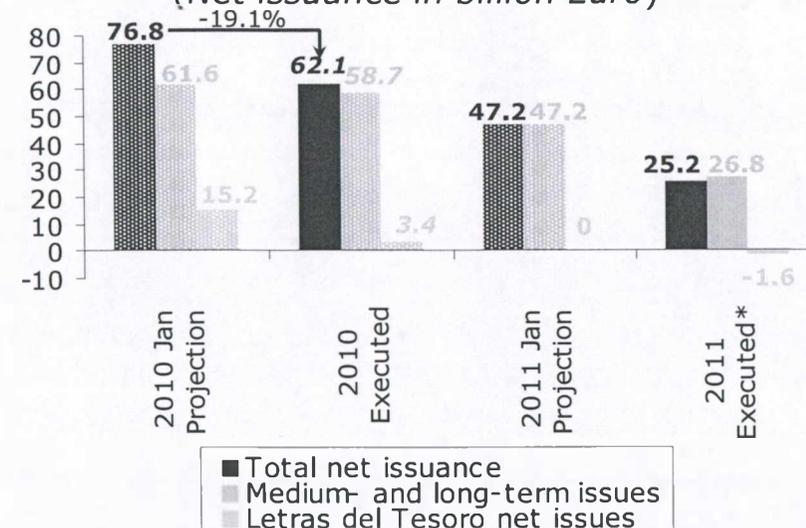
- Funding requirement 24% lower than 2010 execution, in accordance with frontloading of fiscal restraint measures
- As of August 31st, the gross issuance of medium- and long-term bonds stands at €59.5bn, 63.4% of the initially projected figure

Tesoro funding in 2011 (Billion Euro)

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

Source: *Dirección General del Tesoro y Política Financiera.*

Funding Programme. 2010-2011
(Net issuance in billion Euro)



* As of August 23rd 2011.

- Privatisations and new fiscal restraint measures imply lower funding needs than initially projected in the January 2011 programme



The funding programme in 2011 (II)

- Monthly announcements + potential off-the-run medium and long-term lines announced Friday prior to the auction
- Limit size per line: 16.5 bn € for lines of 10-years and above
- Tesoro Público is open to additional foreign currency issuance
- Private placements/Schuldschein loans

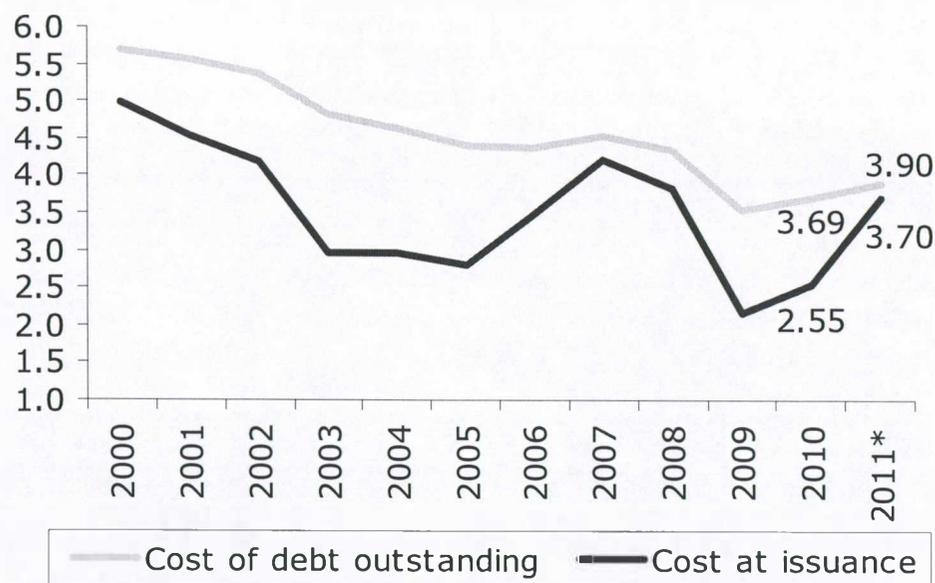
Auctions	Short-term	Letras del Tesoro	
		3- & 6-Month 4th Tuesday of every month	12- & 18-Month 3rd Tuesday of every month
	<i>Yearly calendar</i>		
	Medium- and long-term	Bonos del Estado	Obligaciones del Estado
3, 5-year benchmarks and off-the-run bonds 1st Thursday of every month		10, 15, 30 -year benchmarks and off-the-run bonds 3rd Thursday of every month	
<i>Monthly announcement on 1st Thursday of every month (Obligaciones of current month and Bonos of next month)</i>			

- New since July 29th: modification of the tax procedure to simplify the obligations of non-resident investors for the actual perception of their interest income free of withholding taxes. Investor identification obligations are eased and broadened in their geographical scope

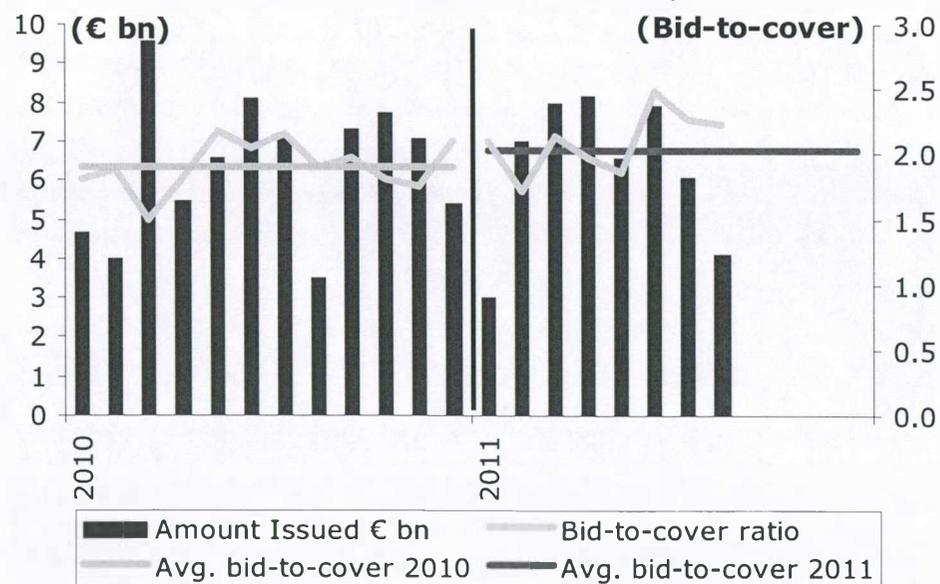
Funding execution snapshots

- Around 82% of the funding programme carried out 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)



Auctions of Bonos and Obligaciones
(up to August 31st 2011)



Source: *Dirección General del Tesoro y Política Financiera.*

* As of July 31st 2011.

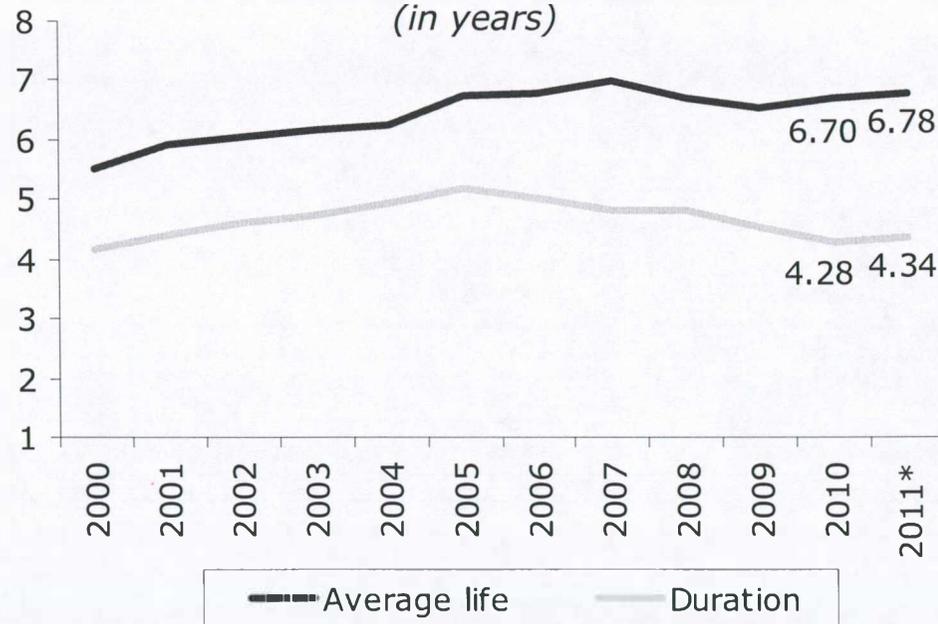
Source: *Dirección General del Tesoro y Política Financiera.*



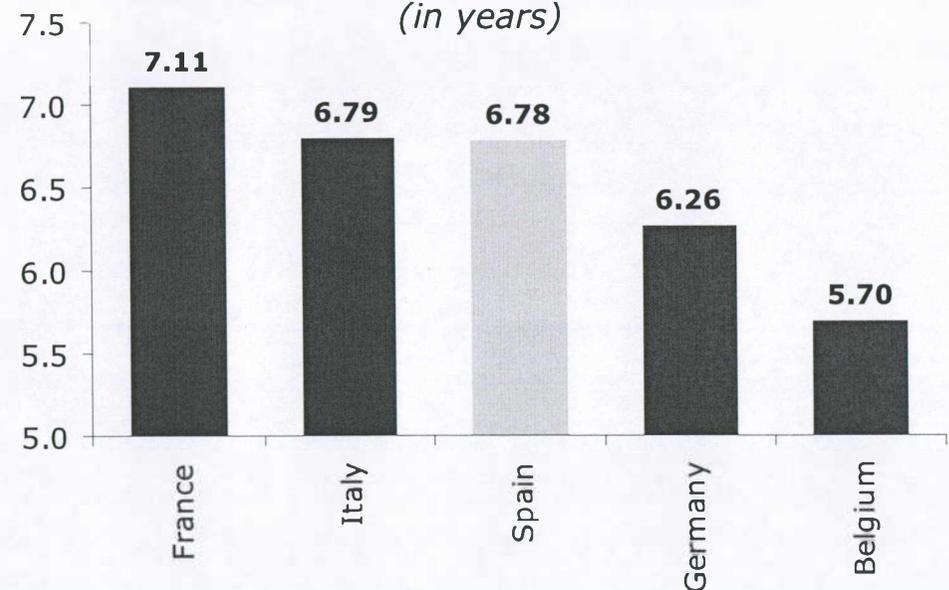
Lengthening of average life has enabled a prudent debt management

- Average portfolio maturity has increased thanks to a reduced issuance of T-Bills and focus on medium- and long-term supply
- This effort helps reduce refinancing risk, enabling prudent debt management

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



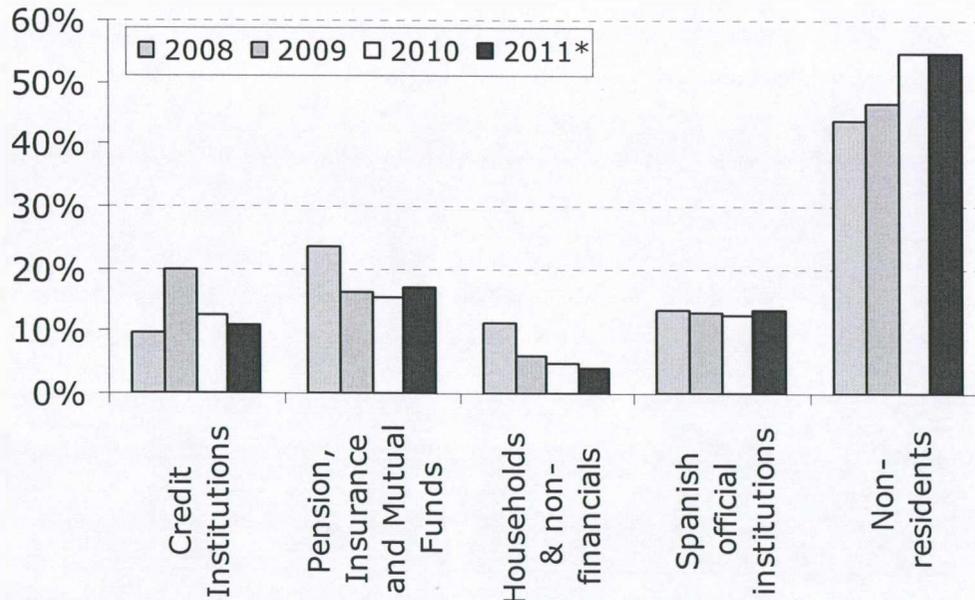
Average life to Maturity. As of July 31st 2011.
(T-Bills and medium and long-term euro-denominated debt,
excluding inflation-linked bonds)
(in years)



A diversified investor base

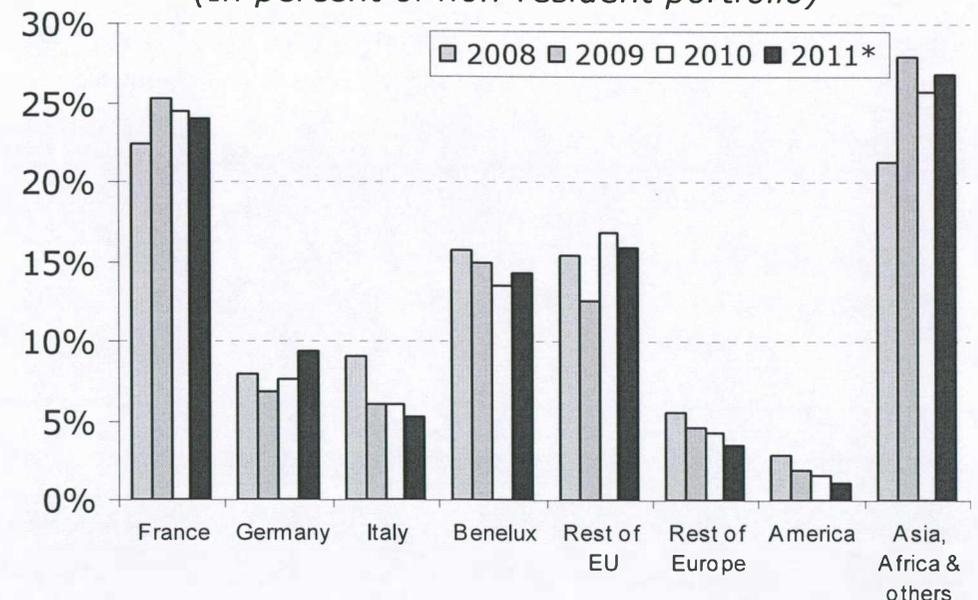
- Non-resident investors have been of instrumental importance throughout various periods of uncertainty
- The geographical distribution of holdings of government bonds has remained relatively stable during the last two years

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



Source: *Dirección General del Tesoro y Política Financiera.*
* As of July 31st 2011.

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

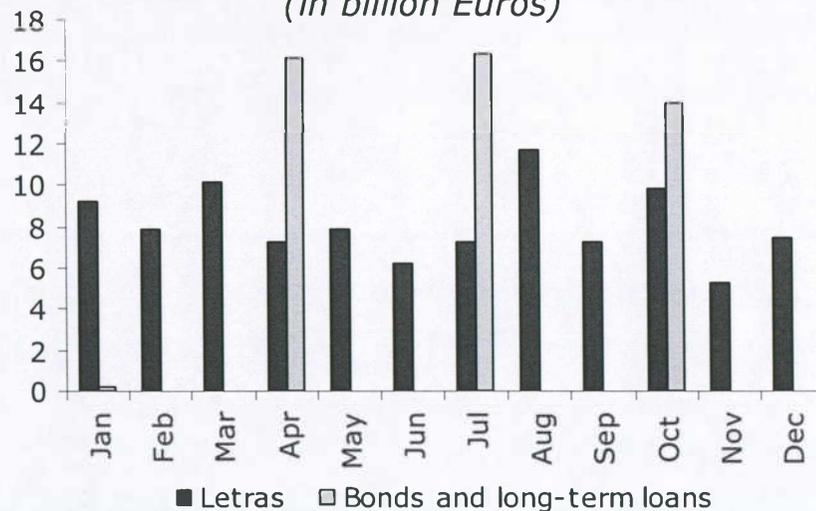


Source: *Dirección General del Tesoro y Política Financiera.*
* As of July 31st 2011.

Robust Treasury Management System

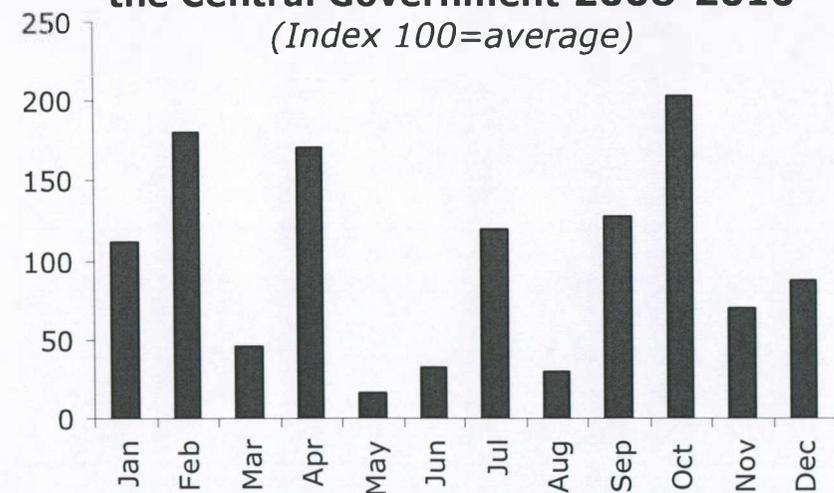
- Redemption dates of medium- and long-term bonds (principal and coupons) match the biggest inflows of tax revenues
- Transparency: regular and publicly available information about budgetary execution, change in cash balances, non resident holdings,...
- Issuance schedule based on very conservative assumptions about budget execution
- Excess liquidity is lent in the money market each month through repo auctions
- Liquidity lines with banks provide an additional buffer

Monthly maturity structure as of July 31st 2011
(in billion Euros)



Source: *Dirección General del Tesoro y Política Financiera.*

Average seasonal index of tax revenues of the Central Government 2008-2010
(Index 100=average)



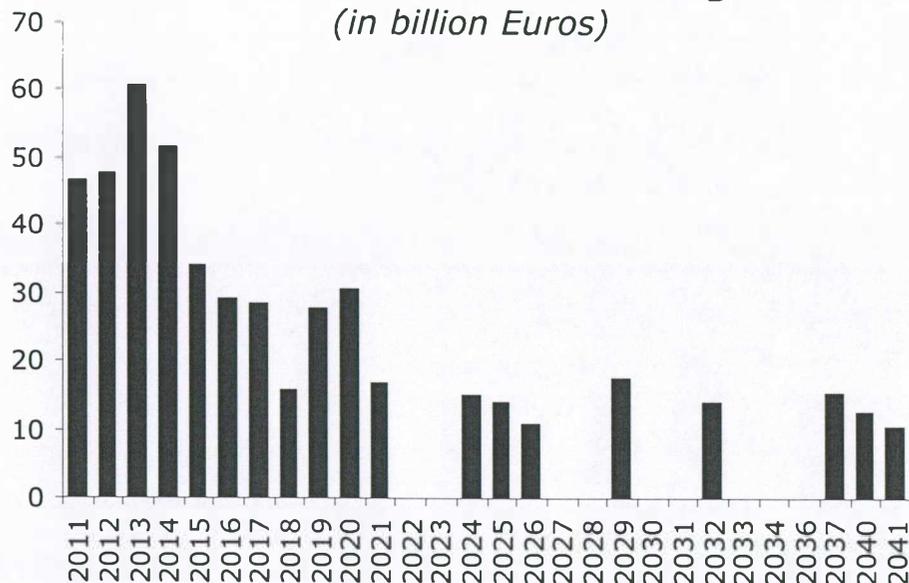
Source: *IGAE.*



Risk and refinancing measures

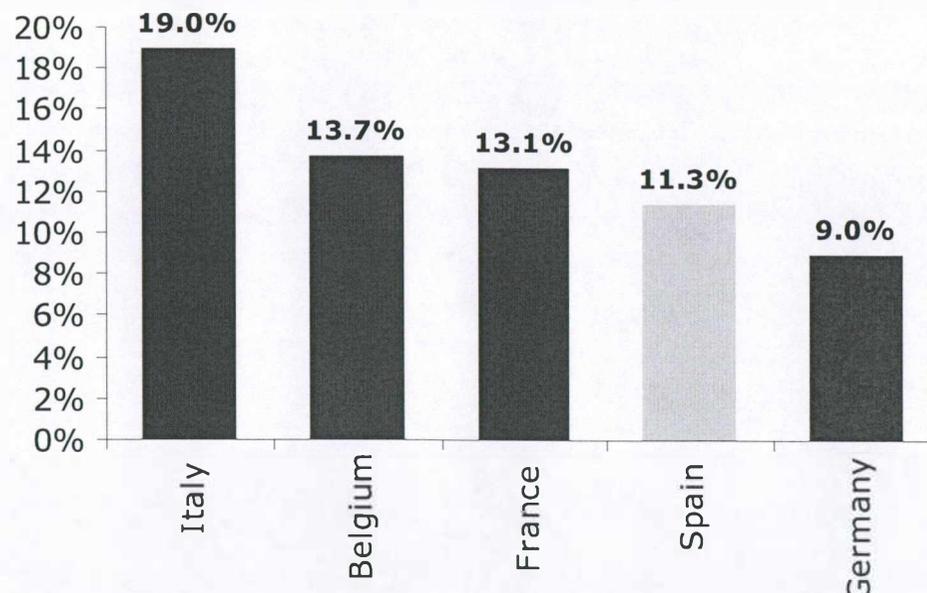
- Refinancing risk remains subdued thanks to a longer average life
- Redemptions of Euro-denominated debt remain well in line with those of peers

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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