

I. EXECUTIVE SUMMARY

The debt to GDP ratio for the General Government sector reached 100.5% in June 2016 (€1,106.69m), some 65 percentage points above the minimum reached in March 2008. This is the third time in recent quarters that the threshold of 100% of GDP is crossed, a figure not seen since the period 1898-1909. This ratio makes Spain the sixth most indebted economy in the eurozone, after Greece, Italy, Portugal, Cyprus and Belgium.

Regarding the evolution observed over this second quarter for the various subsectors, the Central Administration and the Social Security Funds have jointly reached a debt ratio of 72.5% of GDP (as opposed to 73.1% in the first quarter of 2016). For the Autonomous Regions, this ratio reached 24.8% of GDP (€273.20m), five tenths of a percentage point higher than the level reached in the first quarter of 2016 but still far from the reference level of 13% of GDP. The debt ratio for the Municipalities (Local Corporations) remained unaltered at 3.2%, very close to the reference level of 3% of GDP.

Considerable heterogeneity is observed within the Autonomous Regions subsector. In nominal terms, the greater part of the regions (over 40% of the total) is concentrated in two of them: Cataluña (€74.76m) and Comunitat Valenciana (€43.16m). Considering the debt in terms of the regions' GDP, Illes Balears and Castilla-La Mancha also stand out with values exceeding 30%.

With the aim of rendering the meaning of the figures for each region in more tangible terms, AIReF has included in this analysis a comparison among the various territories centred on the number of days the citizens of each region would have to work to repay the debt. In this analysis, a distinction is made between the debt pertaining to each region, on the one hand, and the territorial share of the common debt (chiefly corresponding to the Central government and Social Security) on the basis of the relative population, on the other hand.

Thus, in regions such as Cataluña, Comunitat Valenciana, Illes Balears, Murcia and Castilla-La Mancha, over 100 days' work are needed per person to repay the region's total debt. In terms of relative increase since the year 2007, the region of Madrid has deteriorated the least; here, the number of work days has increased barely threefold to reach almost 53 in 2016. If the common debt is also shared among regions, the situation in Extremadura, Castilla-La Mancha, Comunitat Valenciana, Andalucía and Región de Murcia stand out at the opposite extreme with figures approaching (or exceeding) 450 days to repay the region's total debt.

Furthermore, the increasing weight of the extraordinary financing mechanisms in Andalucía, Illes Balears, Castilla La-Mancha and Cataluña, where 60% of their total debt is exceeded, or in Murcia and Valencia, with values in excess of 70%, must be noted.

Looking ahead, the debt to GDP ratio for the General Government sector presents a sustainable or decreasing profile, especially as of 2018, according to the simulations associated to AReF's neutral scenario. The rate of decline would imply reaching the limit of 60% by 2036, which is a far cry from the year 2020, as called for in the Transitional Provision One of the Organic Law on Budgetary Stability and Financial Sustainability.

Having tested this path in different stress scenarios with regard to the main determinants, we must highlight the importance of the assumption made regarding the effort in primary terms. Indeed, the sensitivity analysis for the neutral path under real, financial and economic policy disruptions shows that (i) temporary macroeconomic shocks, such as slower economic growth or an increase in interest rates, fail to alter the sustainable dynamics of the decreasing debt ratio, and (ii) the assumptions regarding the evolution of the primary balance are key to the dynamics over the coming years, given that a smaller fiscal effort may lead to an unsustainable path. Although the General Government sector is not expected to reach the debt limit of 80% of GDP until 2036, the situation for the different subsectors is fairly heterogeneous. The Central Government and the FSS, along with all the autonomous regions, are expected to reach their reference values of 44% and 13% of GDP, respectively, by around the year 2036 (although some regions, namely Castilla La-Mancha, Catalonia, Murcia and Valencia, may not reach it until beyond 2040). Lastly, the Local Corporations are in a more favourable position and may meet the target of 3% of GDP in the current year, 2016.

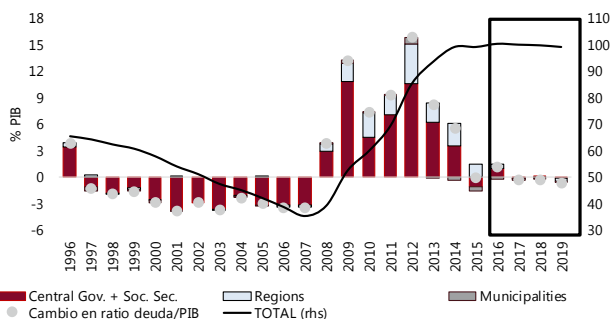
TABLE 1. DEBT AND DERIVED INDICATORS. GENERAL GOVERNMENT SECTOR, SUBSECTORS, AND BREAKDOWN OF AUTONOMOUS REGIONS (% OF GDP)

| | 2007 | 2015 | 2016-II | Debt Dynamics | | | | Days needed to repay the debt ³⁾ 2016 | | | | Rating ⁴⁾ | | | Financing cost 2016 | | FLA and financing mechanisms (% debt) 2016-II | | |
|--------------------------|------|------|---------|---------------|-------|------|------|--|-------------|------------|---------------|----------------------|------------|------------|---------------------|------|---|------|------|
| | | | | 2016 | 2017 | 2018 | 2019 | 2016 regional | 2016 shared | 2016 total | Δ 07-16 total | Moody's | S&P | Fitch | Implicit Int. Rate | %GDP | | | |
| AAPP ²⁾ | 35,5 | 99,3 | 100,5 | 100,5 | 100,2 | 99,9 | 99,3 | - | - | - | - | - | - | - | 2,6 | 2,7 | - | | |
| AC+FSS | 27,1 | 71,7 | 72,5 | 72,8 | 72,7 | 72,7 | 72,6 | - | - | - | - | - | Baa2 (4) ↔ | BBB+ (4) ↔ | BBB+ (4) ↔ | 3,0 | 2,4 | - | |
| CCLL | 2,7 | 3,2 | 3,2 | 2,9 | 2,7 | 2,5 | 2,4 | - | - | - | - | - | - | - | 1,4 | 0,0 | 20,5 | | |
| TOTAL CCAA ²⁾ | 5,7 | 24,4 | 24,8 | 24,9 | 24,8 | 24,7 | 24,4 | - | - | - | - | - | - | - | 1,4 | 0,3 | 49,3 | | |
| ANDALUCIA | 4,8 | 21,8 | 22,0 | 22,1 | 21,8 | 21,7 | 21,2 | 81 | 375 | 456 | 297 | - | Ba1 (5) ↔ | BBB (4) ↔ | BBB- (4) ↔ | 1,0 | 0,2 | 65,1 | |
| ARAGON | 3,4 | 20,5 | 21,6 | 21,8 | 22,4 | 22,7 | 23,1 | 80 | 252 | 332 | 220 | - | - | BBB- (4) ↔ | - | 2,3 | 0,5 | 26,8 | |
| PRINCIPADO DE ASTURIAS | 3,2 | 18,0 | 19,5 | 18,1 | 18,6 | 18,4 | 18,2 | 66 | 311 | 377 | 246 | - | - | - | BBB (4) ↔ | - | 1,0 | 0,2 | 36,4 |
| ILLES BALEARS | 6,9 | 30,2 | 30,7 | 30,7 | 29,6 | 28,7 | 28,3 | 112 | 263 | 375 | 247 | - | - | BBB- (4) ↔ | - | 1,0 | 0,3 | 61,6 | |
| CANARIAS | 3,7 | 15,8 | 15,7 | 15,5 | 14,8 | 14,1 | 13,4 | 57 | 323 | 380 | 243 | - | - | BBB+ (4) ↔ | BBB- (4) ↔ | 1,0 | 0,1 | 59,6 | |
| CANTABRIA | 3,4 | 22,0 | 22,5 | 22,7 | 22,9 | 23,4 | 22,9 | 83 | 310 | 393 | 265 | - | - | - | BBB (4) ↔ | - | 1,7 | 0,4 | 58,6 |
| CASTILLA Y LEÓN | 3,4 | 19,5 | 20,0 | 19,7 | 19,9 | 19,6 | 19,2 | 72 | 294 | 366 | 235 | - | Baa2 (4) ↔ | - | - | 2,2 | 0,4 | 18,7 | |
| CASTILLA-LA MANCHA | 4,7 | 35,6 | 35,8 | 36,1 | 36,2 | 36,2 | 35,7 | 132 | 351 | 482 | 330 | - | Ba2 (5) ↔ | - | BBB- (4) ↔ | 1,1 | 0,4 | 65,3 | |
| CATALUDIA | 7,8 | 35,5 | 35,9 | 36,0 | 35,8 | 36,1 | 35,8 | 131 | 233 | 364 | 243 | - | Ba3 (5) ↓ | B+ (6) ↓ | BB (5) ↔ | 1,2 | 0,4 | 61,3 | |
| EXTREMADURA | 4,5 | 20,3 | 22,4 | 22,8 | 24,0 | 24,5 | 24,3 | 83 | 401 | 484 | 306 | - | Baa3 (4) ↔ | BBB (4) ↔ | - | 1,7 | 0,3 | 37,6 | |
| GALICIA | 6,6 | 18,6 | 18,9 | 18,6 | 18,4 | 17,9 | 16,7 | 68 | 313 | 381 | 230 | - | Baa2 (4) ↔ | BBB+ (4) ↔ | - | 2,3 | 0,4 | 19,1 | |
| COMUNIDAD DE MADRID | 5,2 | 13,7 | 14,2 | 14,4 | 14,6 | 14,8 | 14,8 | 53 | 203 | 255 | 154 | - | Baa2 (4) ↔ | BBB+ (4) ↔ | BBB (4) ↔ | 2,5 | 0,3 | 6,6 | |
| REGION DE MURCIA | 2,3 | 27,4 | 28,9 | 29,2 | 29,5 | 29,9 | 30,0 | 106 | 339 | 446 | 307 | - | Ba2 (5) ↔ | - | BBB- (4) ↔ | 1,4 | 0,4 | 71,1 | |
| C. FORAL DE NAVARRA | 3,6 | 18,2 | 20,4 | 18,3 | 18,0 | 17,5 | 16,7 | 67 | 225 | 292 | 190 | - | - | A (3) ↔ | - | 2,9 | 0,5 | 0,0 | |
| PAIS VASCO | 1,0 | 14,4 | 15,6 | 14,5 | 14,2 | 13,8 | 13,4 | 53 | 211 | 264 | 174 | - | Baa1 (4) ↔ | A (3) ↑ | BBB+ (4) ↔ | 1,5 | 0,2 | 0,0 | |
| LA RIOJA | 3,5 | 18,0 | 18,6 | 18,0 | 18,0 | 18,0 | 17,5 | 66 | 250 | 316 | 201 | - | - | - | BBB (4) ↔ | 0,7 | 0,1 | 18,0 | |
| COMUNITAT VALENCIANA | 11,3 | 41,3 | 41,7 | 42,2 | 41,5 | 41,3 | 40,6 | 154 | 310 | 464 | 302 | - | Ba2 (5) ↔ | BB (5) ↔ | BBB- (4) ↔ | 1,0 | 0,4 | 70,7 | |

Source: INE, IGAE, Bank of Spain, DatosMacro.com and AIREF estimates (simulation for the neutral path)

Notes: 1) The debt to GDP ratios published by the Bank of Spain have been calculated taking the nominal GDP estimated by INE for the latest Quarterly update of the National Accounts and do not include the updates performed by INE on 14 September on the annual 2012-2015 . **2)** For the data disseminated by the Bank of Spain on the debt-to-GDP ratio for market prices in each of the Autonomous Regions, the corresponding regional GDP pm as published by INE has been taken, except for the latest available data; in this case, the regional structure of the Spanish Regional Accounting is applied to the aggregate for the last four quarters of nominal GDP. In the projected figures, the estimate for nominal regional GDP is calculated following the METCAP-AIREF methodology. **3)** The number of days per person required to repay the debt, in the regional case, derives from multiplying by 365 the ratio of said debt to the respective regional GDP. For common debt (Central Government and Social Security Funds plus the Local Corporations subsector), this is distributed among the regions according to the size of the population in each region, so that the resulting debt ratio to the corresponding regional GDP is then multiplied by 365. **4)** (M) Moody's, (F) Fitch and (S) Standard and Poor's. The quality rating may be (3) Upper standard grade, (4) Lower standard grade, (5) Non-speculative investment grade, and (6) Highly speculative.

GRAPH 1. CONTRIBUTION TO THE VARIATION IN TOTAL GENERAL GOVERNMENT SECTOR DEBT BY SUBSECTORS (% GDP)

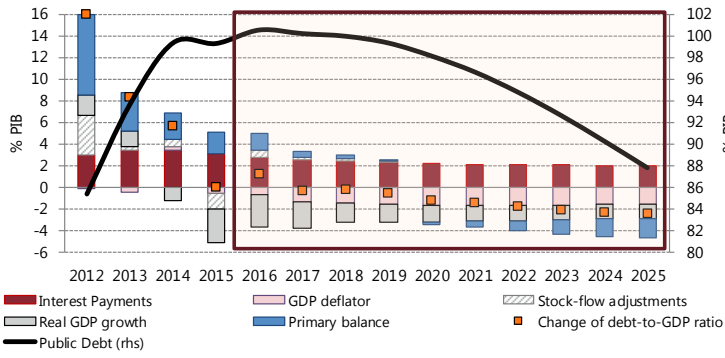


- The debt to GDP ratio for the General Government sector reached 100.5% in June 2016.
- According to the Stability Programme Update 2016-2019, this ratio is expected to reach 99.1% by the end of 2016.
- In annual terms, at 2015 year end the ratio ceased to grow for the first time since 2008, owing to the reduction experienced by Local Corporations (0.5%) and by the Central Government + FSS (1%) that offset the increase observed for the Autonomous Regions (1.5%).

Source: INE, IGAE, Bank of Spain and AIREF estimations

GRAPH 2, 3 AND 4. EVOLUTION IN THE DEBT TO GDP RATIO AND SENSITIVITY ANALYSIS

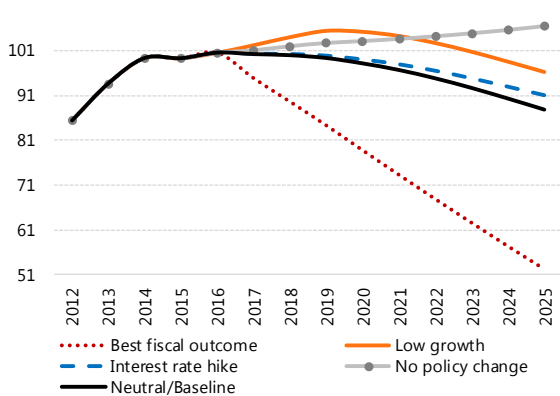
DEBT DYNAMICS AND DETERMINANTS, NEUTRAL SCENARIO (% GDP)



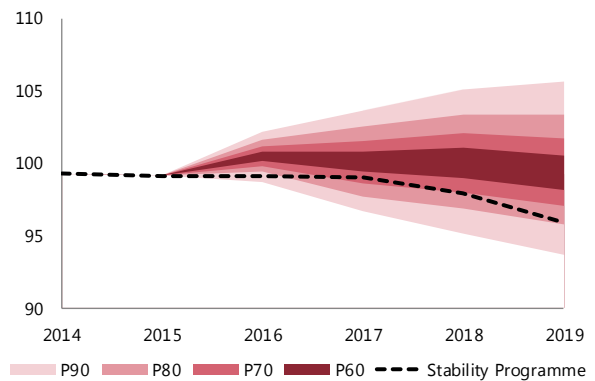
- Expected to enter a downward trend after 2018, but insufficient to reach the 60% of GDP by 2020.
- Improvement to the primary balance will contribute steadily to reducing the ratio as of the year 2020.
- The denominator effect will roughly compensate for the burden of interest from 2016.
- Macroeconomic shocks are not expected to alter the debt reduction dynamics.
- The assumptions made regarding the evolution of the primary balance are key to establishing the dynamic for the next few years.
- From a probabilistic viewpoint, the debt path underpinning the SPU is mildly optimistic.

Source: INE, IGAE, Bank of Spain and AIReF estimations

DEBT DYNAMICS IN DIFFERENT SCENARIOS (% GDP)



DEBT DYNAMIC, STOCHASTIC SCENARIOS AND STABILITY PROGRAMME FOR 2016-2019 (% GDP)

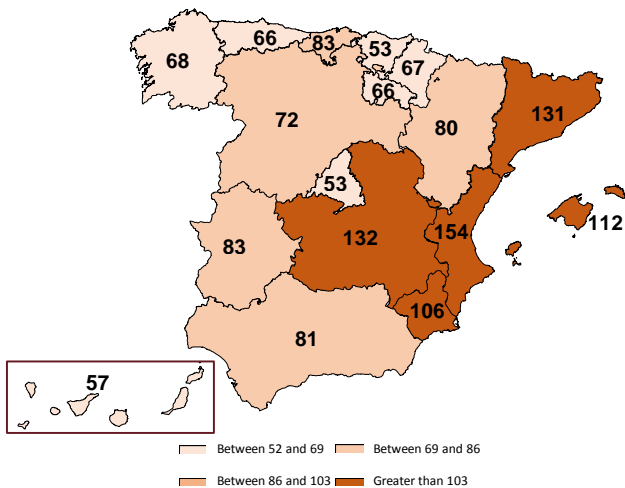


Source: INE, IGAE, Bank of Spain and AIReF estimations

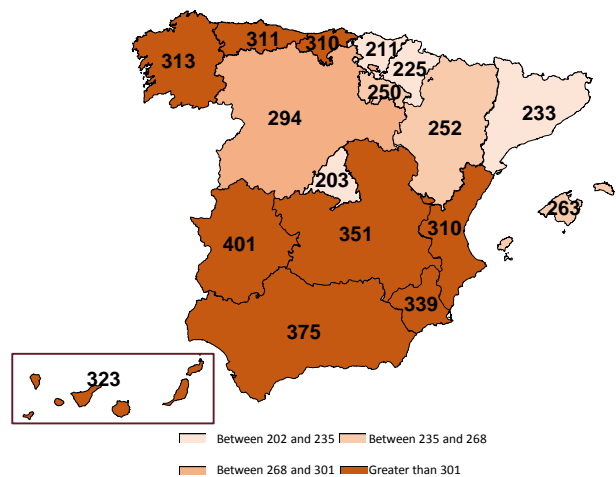
Source: INE, IGAE, Bank of Spain and AIReF estimations

GRAPHS 5 AND 6. DEBT INDICATORS PER INHABITANT (NUMBER OF DAYS)

DAYS NEEDED TO REPAY THE AUTONOMOUS REGION'S DEBT (2016)



DAYS NEEDED TO REPAY THE COMMON DEBT (2016)



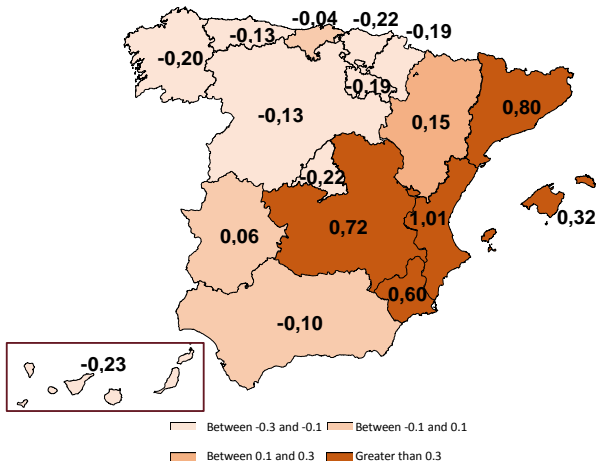
Source: INE, IGAE, Bank of Spain and AIReF estimations

Source: INE, IGAE, Bank of Spain and AIReF estimations

Note: The number of days per person required to repay the debt, in the regional case, derives from multiplying by 365 the ratio of said debt to the respective regional GDP. For common debt (Central Government and Social Security Funds plus the Local Corporations subsector), this is distributed among the regions according to the size of the population in each region, so that the resulting debt ratio to the corresponding regional GDP is then multiplied by 365.

GRAPHS 7, 8 AND 9. FISCAL EFFORT INDICATORS

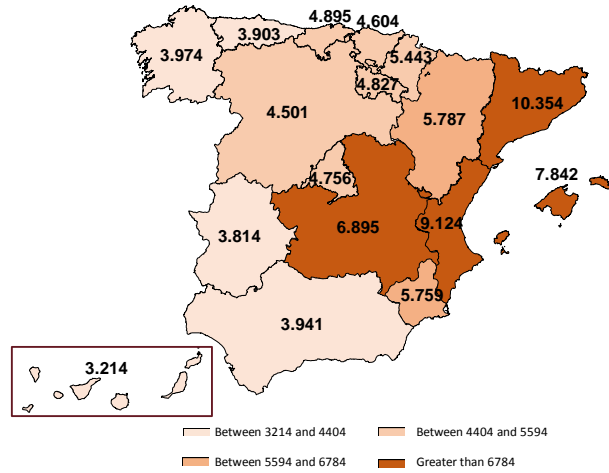
S1 FISCAL EFFORT INDICATOR PER REGION: 2016



Source: INE, IGAE, Bank of Spain and AIReF estimations

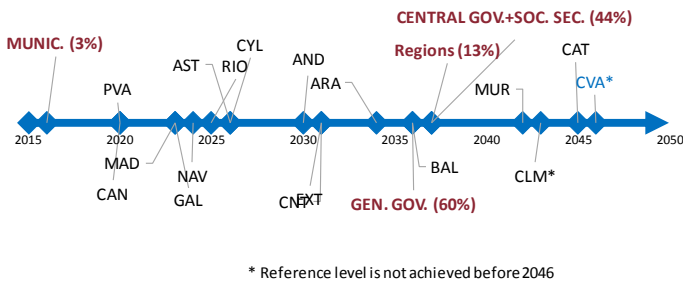
Note: S1 indicator is defined as the mean primary balance required between 2016-2030 to reach the target of 13% of GDP by 2030.

AUTONOMOUS REGIONS DEBT PER CAPITA (EUROS) 2016



Source: INE, IGAE, Bank of Spain and AIReF estimations

YEAR IN WHICH THE REFERENCE VALUE IS MET



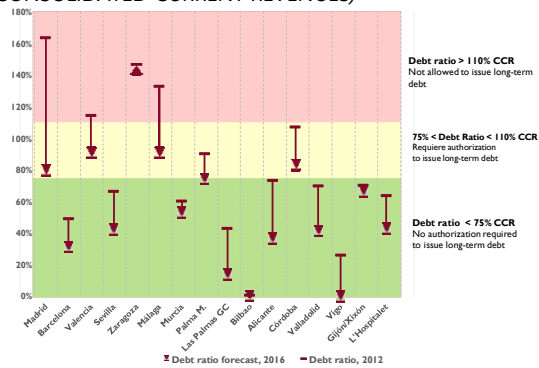
* Reference level is not achieved before 2046

Source: INE, IGAE, Bank of Spain and AIReF estimations

- The Mediterranean regions and Castilla-La Mancha require a greater number of work days per person to repay their regional debt.
- If within each region the number of work days per person needed to repay the corresponding fraction of common debt is calculated, the result is a number exceeding 300 days in the regions of Castilla-La Mancha, Valencia, Murcia, Andalucía, Galicia, Asturias, Cantabria, Islas Canarias and Extremadura (401 days).
- The highest need for consolidation in the medium term, in terms of the S1 indicator, is seen in Aragón, Castilla-La Mancha and the Mediterranean regions, as well as the highest debt per capita figures.
- Only the Local Entities (probably in 2016), País Vasco and Islas Canarias are expected to reach the debt reference levels by 2020.

GRAPH 10. DEBT RATIO AT YEAR-END IN 2012 AND 2016 OVER CURRENT REVENUES

OUTSTANDING DEBT 2012 AND FORECAST FOR 2016 (% CONSOLIDATED CURRENT REVENUES)



Source: City Councils, Bank of Spain and SGCAL and AIReF estimates.

- Individual analysis of the 16 City Councils with a population exceeding 250,000 inhabitants.
- In the debt forecast for 2016, the most favourable assumption is made according to which the surplus obtained is destined entirely to writing off the debt.
- Only Zaragoza is expected to submit, at 2016 year-end, a current debt to consolidated current revenues ratio of more than 110%, due to which it will be unable to enter into new long-term credit operations.
- Madrid has made the greatest effort toward decreasing its level of indebtedness, achieving a reduction of over 80% with regard to its level of outstanding debt in 2012.