Debt Monitor, October 2017

I. EXECUTIVE SUMMARY

The debt-to-GDP ratio for the Autonomous Regions as a whole was 99.8% at the end of the second quarter of 2017, practically unchanged from the first quarter. Data published by the Bank of Spain for the second quarter of 2017 and the updated results from Quarterly National Accounts (QNA) by the National Statistical Institute put the debt-to-GDP ratio for the General Government (GG) at 99.8% (€ 1,137.85 million), just 0.1% below the figure recorded in the previous quarter.

When disaggregating the debt performance by sub-sector, the quarterly decrease in the Central Government (CG) and Social Security Funds (SSF) group has been offset by an increase in the Autonomous Regions (ARs) subsector, while the Local Governments (LG) remain unchanged. In the second quarter of 2017, the CG and SSF group reached a debt-to-GDP ratio of 71.9% (€ 819.53 million), half a point below the previous quarter. For the first time, the debt ratio of the regional subsector as a whole has exceeded 25% Spanish GDP (€ 285.9 million). Within the ARs, increases in Cantabria, Extremadura and Murcia stand out, as well as the decrease in Navarre and Asturias.

Despite the upward revision of GDP in the national accounts and the improvement seen in budgetary execution, the AIReF's neutral scenario continues to project that the achievement of the reference values listed in the LOEPySF for the GG will occur only after 2030. The AIReF's projected neutral scenario forecasts a downward trend but would delay the achievement of the 60% GDP reference value for the GG until at least 2035. At the Regional level, the best performing communities are the Canary Islands, Madrid and the Basque Country, which would reach a level close to the LOEPySF reference value (13% of GDP) within the next 5 years. On the contrary, other regions (i.e. Catalonia, Valencia, and Castilla-La Mancha) would not reach the reference level in the next 30 years (under the assumptions of the neutral scenario). Only the LGs subsector has been able to reach the reference value as early as 2016. As repeatedly mentioned, the factual impossibility of the First Transitory Provision calls for its revision, to provide demanding but more realistic convergence paths to the reference levels, more in line with point 4 of the Provision. In this context, the credit ratings of the Spanish Treasury and the ARs has remained unchanged from the previous quarter.

Alternatively, the debt level, in proportion to the current revenue obtained by each subsector, reflects a very similar image, with the exception of Extremadura and Madrid. Beyond GDP, a benchmark indicator for assessing the sustainability of the various subsectors is their ability to generate revenue to deal with liabilities. In general terms, the results of this indicator are well-stablished in comparison to the debt-to-GDP ratio, with a high correlation between them. However, it should be noted that Extremadura and Madrid stand out in opposite directions. Extremadura is in a much more favourable position when considering current revenue, while Madrid is notable for its position in terms of production.

Since the beginning of 2016, debt-to-current consolidated revenue (CCR) has not decreased by 400% for the AC and FSS group, while the ACs and the LGs being in a much better relative position (185% and 48%, respectively, in the second quarter of 2017).

In the medium term, achieving the path provided in the 2017-2020 Stability Programme Update (SPU) can be considered probable. In the long term, however, the sensitivity analysis indicates there are risks to sustainability, especially in the macro-financial sphere: either due to an increase in the risk premium or to lower economic growth. The probability of achieving a lower debt-to-GDP ratio lower than that forecasted in the SPU in 2017 is very high. However, this likelihood decreases as the time horizon increases, with the risk of observing a 2020 ratio higher than that forecasted in the SPU (and the 2018-2020 debt targets) being approximately 40%. Although the fiscal rules framework provides some certainty regarding the tone of long-term fiscal policy, changes in other macro-financial factors may still pose a risk to debt sustainability. In this sense, in the medium term (2020 horizon), a 200% increase in the risk premium would imply an increase in the debt burden of approximately €15 million, leading to a 2030 difference of 17% in the debt-to-GDP ratio with respect to the neutral path. If the nominal GDP´s growth would decrease simultaneously, (1 point with respect to the neutral path), the debt ratio would leave its downward path, stabilizing at around 95% GDP (26 percentage points above the 2030 neutral scenario), with serious risks to debt sustainability.

The deceleration in access to state funding mechanisms seems to have stabilized, although behaviour at the regional level is very heterogeneous. During the last 4 months, the y-o-y growth rate of the financing mechanisms´ stock for the whole AR subsector has remained at 16-20%with a slight downward trend. However, this result masks very different behaviours at the regional level. On one hand, in Madrid and Asturias, there has been a steady decline in the stock for the last 5 quarters (although moderate in the case of Madrid). This also suggests an increase in the capacity of these regions to issue long-term debt in the market, something that has also been seen in La Rioja this year (Navarra and the Basque Country never lost access to the long-term debt market). On the other hand, thecomplexit to return to the debt market seems to contribute to the fact that in Cantabria, the Balearic Islands, Andalusia, Galicia, Gastilla-La Mancha, Aragon the Canary Islands and Extremadura, the proportion of public mechanisms increases in quarterly terms above the regional subsector´s average. The level and profile of the maturities of the debt could intensify the dependence on the Regional Liquidity Fund (FLA), in the case of not having access to the market. This is evident in the particular case of Valencia, Catalonia and Castilla-La Mancha, whose ratio of financing needs to current revenue exceeds by far the regional subsector average (greater than 40% for the latter two cases). Notwithstanding the above risks, access to the mechanisms still assumes an attenuating factor in regional financing costs and a de facto floor in terms of their credit rating.

At the end of the second quarter of the year, the net debt in bank deposits increased to 1% GDP in the LG subsector. After declining below 3% GDP by the end of 2016, the debt ratio seems to have stabilized. This is partly due to the fact that almost half of the important primary balances recorded by the subsector are being used to increase bank deposits instead of repaying debt. Since the end of 2012, LG deposits have almost doubled in terms of GDP, exceeding € 20 million. Accordingly, the liquid financial assets´net debt falls to 1% GDP.

TABLE 1. DEBT INDICATORS. GOVT. SUBSECTORS. AND BY REGION (% GDP)

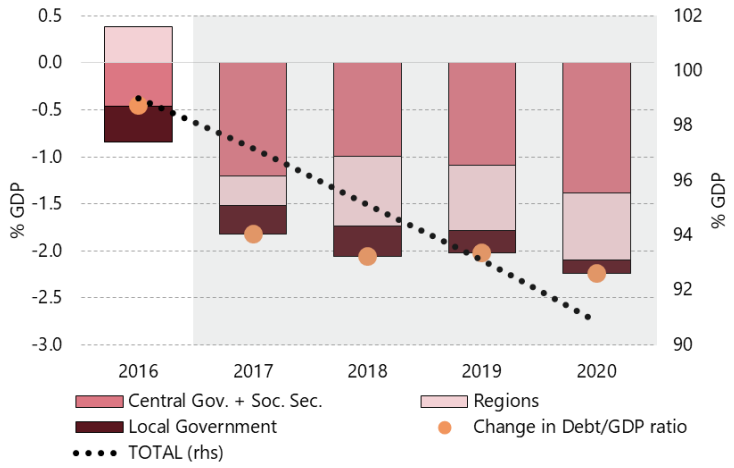
Debt							AIReF Proyections				Necessary days per person to cancel debt [3] 2017				Rating [4]			Debt cost 2016		Public financing mechanisms (% debt)	Debt per capita (€)	Debt / Current Revenue (%) [5]	GFN / Current Revenue (%) [6]	Fiscal effort indicator S1 [7]
	2007	2013	2014	2015	2016	2017q1	2017	2018	2019	2020	2017 regional	2017 commo	2017 total	Δ 07-17 total	Moody's	S&P	Fitch	Implicit rate	%GDP	2017 - II	2017	2017 - II	2017	2017
General Government [1]	35.5	95.5	100.4	99.4	99.0	99.8	97.2	95.1	93.1	90.8	-	-	-	-	-	-	-	2.4	2.5	-	24394	266.7	-	-
Central Adm+SSF	27.1	70.8	73.7	71.8	71.3	71.9	70.1	69.1	68.1	66.7	-	-	-	-	Baa2 (4) ↔	BBB+ (4) ↔	BBB+ (4) ↔	2.7	2.1	-	-	400.3	-	-
Local Corporations	2.7	4.1	3.7	3.3	2.9	2.8	2.6	2.3	2.0	1.9	-	-	-	-	-	-	-	1.9	0.1	18.1	-	47.8	-	-
Total Regions [2]	5.7	20.5	22.9	24.4	24.8	25.1	24.5	23.7	23.0	22.3	-	-	-	-	-	-	-	1.5	0.3	54.9	6139	185.6	25.9	-
ANDALUCIA	4.8	17.8	21.2	22.0	22.4	22.3	22.2	21.4	20.8	20.2	81	363	444	285	Baa3 (4) ↔	BBB (4) ↔	BBB- (4) ↔	1.2	0.3	70.8	4067	137.4	25.6	0.0
ARAGON	3.4	16.5	18.4	20.6	21.6	22.1	21.8	21.5	21.6	22.0	79	244	324	212	-	BBB- (4) ↔	-	2.0	0.4	36.0	5936	173.4	22.2	0.2
P. DE ASTURIAS	3.2	14.8	16.9	18.2	18.9	19.7	18.8	18.3	18.4	18.4	69	306	374	243	-	-	BBB (4) ↔	1.1	0.2	32.7	4101	116.0	16.4	-0.1
ILLES BALEARS	6.9	27.0	29.7	30.6	30.1	30.7	28.9	27.1	25.8	24.1	105	255	360	233	-	BBB (4) ↔	-	1.1	0.3	69.5	7548	199.5	22.8	0.2
CANARIAS	3.7	13.4	15.2	16.3	16.3	16.7	15.4	14.3	13.0	11.5	56	322	378	241	-	BBB+ (4) ↔	BBB (4) ↔	1.1	0.2	68.0	3195	104.7	7.6	-0.4
CANTABRIA	3.4	18.5	20.3	21.9	23.0	23.7	23.4	22.9	23.0	23.0	85	299	384	256	-	-	BBB (4) ↔	1.4	0.3	68.0	5213	137.2	20.7	0.2
CASTILLA Y LEON	3.4	16.4	18.0	19.7	20.4	20.1	20.2	19.9	20.0	20.1	74	282	356	226	Baa2 (4) ↔	-	-	1.8	0.4	18.0	4779	138.9	12.2	0.0
CASTILLA –LA MANCHA	4.7	31.0	36.0	36.3	37.0	36.6	36.8	36.0	35.6	35.3	134	347	482	330	Ba2 (5) ↔	-	BBB- (4) ↔	1.3	0.5	71.0	7057	235.8	32.2	1.0
CATALUNA	7.8	30.1	32.8	35.6	35.4	35.4	35.0	33.9	32.8	31.7	128	223	351	230	Ba3 (5) ↔	B+ (6) ↔	BB (5) ↔	1.5	0.5	68.4	10435	274.4	43.2	0.7
EXTREMADURA	4.5	15.7	18.6	20.7	22.9	23.9	23.0	22.9	23.5	24.0	84	393	477	299	Baa3 (4) ↔	BBB (4) ↔	-	1.5	0.3	46.9	3911	106.5	11.1	0.4
GALICIA	6.6	17.2	18.5	18.6	18.7	19.1	18.8	18.3	18.0	17.8	69	299	368	217	Baa2 (4) ↔	BBB+ (4) ↔	-	1.7	0.3	40.2	4194	124.4	24.2	-0.1
COMUNIDAD DE MADRID	5.2	11.9	13.0	14.1	14.4	15.1	14.2	13.7	13.1	12.3	52	195	247	144	Baa2 (4) ↔	BBB+ (4) ↔	BBB (4) ↔	2.2	0.3	5.9	4874	143.4	15.9	-0.3
REGION DE MURCIA	2.3	20.9	25.7	27.6	29.1	29.7	29.3	28.9	28.6	28.3	107	329	436	297	Ba2 (5) ↔	-	BBB- (4) ↔	1.4	0.4	76.8	5943	194.2	26.7	0.6
C. FORAL DE NAVARRA	3.6	17.9	17.9	18.0	18.2	19.3	18.1	17.6	17.1	17.7	66	214	280	179	-	A (3) ↔	-	2.3	0.4	-	5626	100.5	12.8	0.0
PAIS VASCO	1.0	13.2	13.9	14.3	14.5	15.3	14.4	14.1	13.9	13.6	53	201	254	164	Baa1 (4) ↔	A (3) ↔	BBB+ (4) ↔	1.6	0.2	-	4762	111.3	12.1	-0.2
LA RIOJA	3.5	15.2	17.0	18.2	18.5	19.4	18.1	17.4	17.3	17.0	66	248	314	199	-	-	BBB (4) ↔	0.5	0.1	17.1	4858	138.1	26.8	-0.1
COMUNITAT VALENCIANA	11.3	34.1	38.5	41.4	42.5	41.8	41.6	40.3	38.6	36.8	152	298	450	288	Ba2 (5) ↔	BB (5) ↔	BBB- (4) ↔	0.9	0.4	78.7	9305	288.0	43.4	0.9

Source: INE, IGAE, Bank of Spain, DatosMacro.com and AIReF projections (projections corresponding to the neutral scenario).

Notes: 1) The debt-to-GDP ratios published by the Bank of Spain are calculated using the nominal GDP estimated by INE in the latest quarterly national accounting. **2)** For the data published by the Bank of Spain on the debt-to-GDP ratio for market prices in each of the Autonomous Regions, it has been used the corresponding regional nominal GDP as published by INE, 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, results from multiplying by 365 the regional debt-to-GDP ratio. 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. **5)** S1 indicator is defined as the average primary balance required between 2017 and 2030 to reach the target of 13% of GDP by 2030.

Public debt monitor 2nd quarter 2017. Latest data from 2nd October, 2017.

GRAPH 1. CONTRIBUTION TO THE CHANGES IN DEBT-TO-GDP RATIO

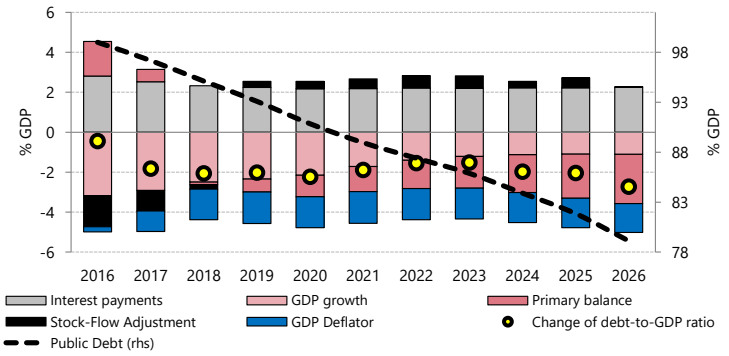


- The latest data published by the Bank of Spain put the 2017Q2 debt at 99.8% of GDP, practically unchanged from 2017Q1. The 0.5% decrease in CG+SSF has been offset by an increase of 0.4% in AR, with no changes in the LGs.
- The AIReF's neutral scenario projects all subsectors to contribute to the reduction of the debt ratio in the next 4 years, with a little more than half the reduction due to the evolution of the CG+SSS subsector and to a lesser extent, the ARs.

Source: INE, IGAE, Bank of Spain, Ministry of Economy, Industry and Competitiveness and AIReF forecasts

GRAPH 2, 3 AND 4. EVOLUTION OF THE GDP RATIO AND SENSITIVITY ANALYSIS

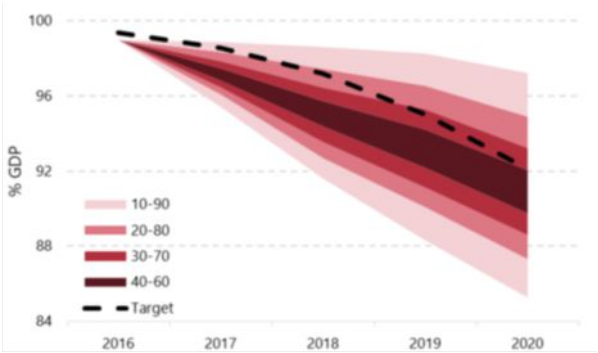
DYNAMICS OF THE DEBT AND DETERMINANTS NEUTRAL SCENARIO (% GDP)



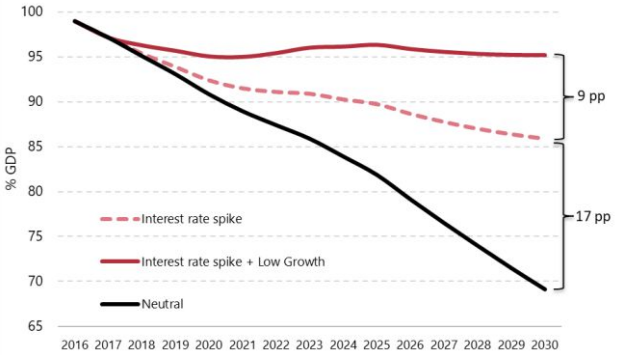
Source: INE, IGAE, Bank of Spain and AIReF estimates

- The neutral scenario projects a slight but sustained decrease in the debt ratio over the next 10 years, being less than 80% GDP in 2026.
- The deceleration of the economic growth is counterbalanced by a gradual improvement in primary balances. The interest burden remains relatively stable at around 2%
- The likelihood of incompliance with the 2018-2020 debt targets increases to more than 40% in 2020.
- A permanent increase of 200 basic points in interest rates would mean a difference of 17 p.p. in 2030, with respect to the neutral path. If nominal GDP growth simultaneously decreases by 1 p.p., the debt ratio would stabilize around 95%, with serious risks to sustainability

DYNAMICS OF DEBT AND CONFIDENCE INTERVALS



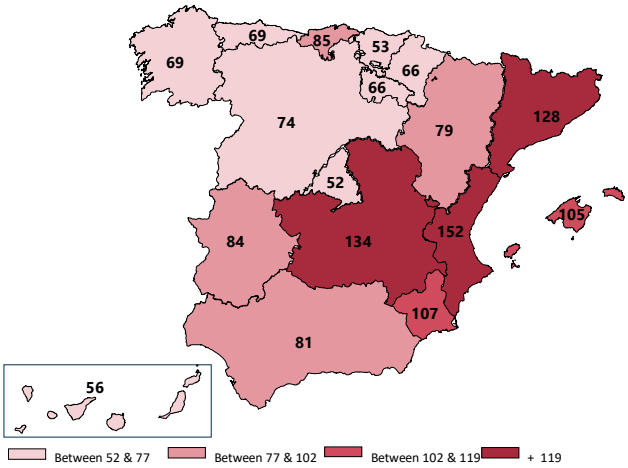
SENSITIVITY ANALYSIS IN MACRO-FINANCIAL ASSUMPTIONS



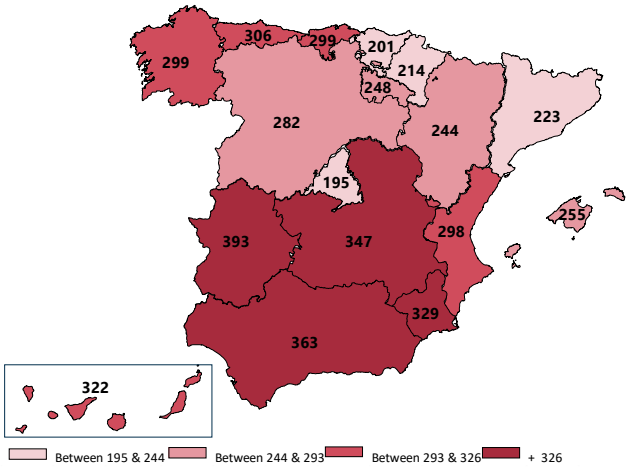
Fuente: INE, IGAE, Bank of Spain and AIReF forecasts. **Note:** *Neutral:* means a gradual improvement in the primary balance to approximate the budgetary balance (including the interest burden), nominal growth that converges to 3.3% in the long term (1.5% in real terms) and a consistent trend with those observed for the forward curve of the Treasury on 11/09/2017. *Increase in interest:* Permanent increase in the rate curve by 200 basic points, with respect to the neutral scenario. *Increase in interest + lower growth:* Aggregate impact of nominal growth of less than 1 p.p. and a permanent increase of interest rates of 200 b.p.

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

DAYS NEEDED TO REPAY THE AUTONOMOUS REGION'S DEBT (2017)



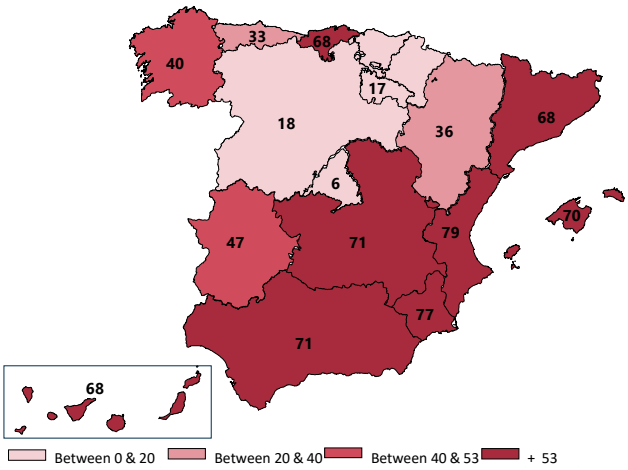
DAYS NEEDED TO REPAY THE COMMON DEBT (2017)



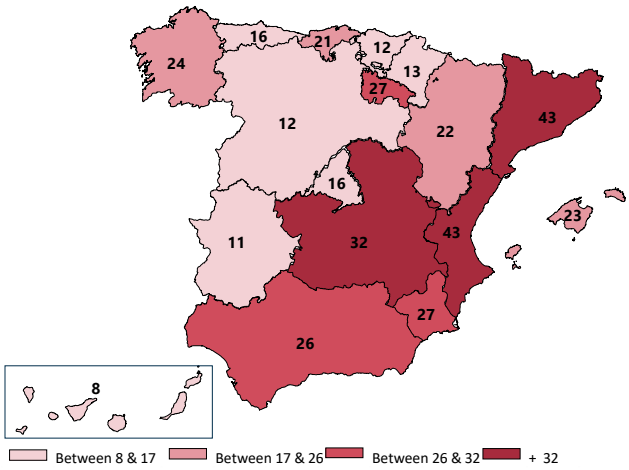
Source: INE, IGAE, Bank of Spain and AIReF estimates. **Note:** The number of days per person required to repay the debt, in the regional case, derives from multiplying by 365 the ratio of said debt to the respective regional GDP. For common debt (Central Government and Social Security Funds plus the 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. STATE FINANCING DEPENDENCE

FINANCING MECHANISMS AS % OF REGIONAL DEBT (2017Q2)

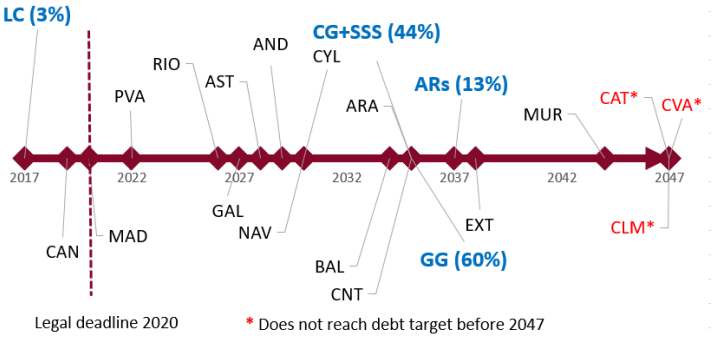


FINANCING NEEDS IN 2017 (% OF CURRENT REVENUE)



Source: INE, IGAE, Bank of Spain and AIReF estimates.

YEAR IN WHICH REFERENCE VALUE IS MET

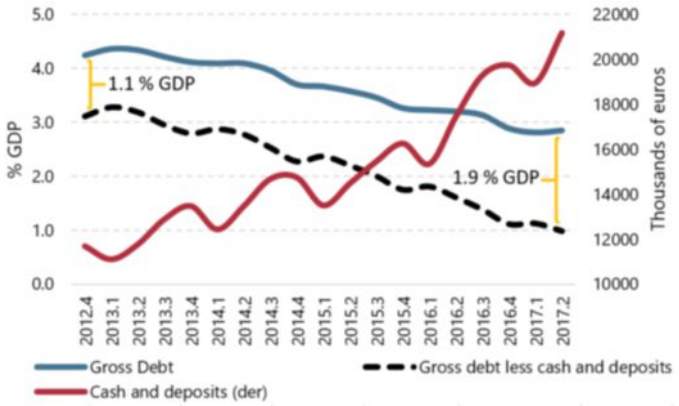


Source: INE, IGAE, Bank of Spain and AIReF estimates.

- By 2017, on average, a person in Spain would need to allocate 89 working days to repay the entire regional debt. In PVA or MAD, that figure is around 50 days, whereas in BAL, CAT, CLM and MUR, this figure exceeds 100 days, almost 150 in the case of CVA.
- In MUR, CVA, AND, CNT, BAL, CAT and CLM, the State financing mechanisms account for more than 60% of the regional debt. In the medium term, these percentages are estimated to decrease only for AST, CYL, MAD, RIO and CVA.
- The gross financing needs for 2017 represent of the current revenue recorded in 2016 for the AR subsector. The relative position of the various ARs follows a pattern similar to the debt-to-GDP ratio, except for EXT and MAD.
- The AIReF projects the GG to fail reaching a debt level below 60% GDP before 2035 in the neutral scenario. Only CAN and MAD will reach the reference level before 2020 (the EELL did it already in 2016).

GRAPH 10. DETERMINANTS OF LOCAL GOVERNMENT SUBSECTOR DEBT

EVOLUTION OF DEBT/ICC RATIO



- After declining below 3% GDP at the end of 2016, the debt ratio seems to have stabilized. This is partly due to the fact that almost half of the primary balances recorded by the subsector are being used to increase bank deposits instead debt repayment.
- Since the end of 2012, LG deposits have almost doubled in terms of GDP, exceeding €20 million. Accordingly, the net debt of liquid financial assets falls to 1% GDP.

Source: Bank of Spain and AIReF estimates..
Note: The debt ratio is calculated using the period debt ratio over the sum of the GDPs for the last 4 quarters.