Public Debt Monitor, 2017-1

I. EXECUTIVE SUMMARY

The debt-to-GDP ratio for the General Government sector dropped four tenths of a percentage point in 2016 up to the target of 99.4%. However, in nominal terms public indebtedness has reached a new historic annual peak. Moreover, the legal requirement for a yearly reduction of at least 2% of GDP has not been met. As shown in the data published by the Bank of Spain for 4Q 2016, the debt-to-GDP ratio for the General Government (GG) sector overall reached 99.4% (€1,106.95m), four tenths of a percentage point less than the data for the preceding year, meeting the target set by agreement at the Council of Ministers on 2 December 2016. As in 2015, the decrease in the debt-to-GDP ratio in 2016 has not fulfilled the requirement stated in paragraph 2 of Transitional Provision One (DT-1) of the LOEPySF 2/2012, with respect to a yearly decrease of at least 2 pp of the debt-to-GDP ratio while the growth rate for both real GDP and employment surpassed the 2% per year mark. Similarly, the 2017 General State Budget foresees 2.5% growth in real GDP and employment and a decrease in the debt-to-GDP ratio of just 0.4 pp.

In terms of individual performance, all subsectors but the Autonomous Regions have reduced their debt-to-GDP ratio. For the whole of 2016, the Central Government (CG) and the Social Security Funds (SSF) together reached a debt ratio of 71.6% of GDP, four tenths of a percentage point below the figure for 2015 and falling short of the 72% target. For the Local Corporations (LCs) overall, the ratio reached 2.9% of GDP (€32.09m), four tenths of a percentage point less than in 2015 and short of the 2016 target of 3%. In the Autonomous Regions (AR) subsector overall, debt increased by €13.65m with regard to that of 2015, giving rise to an increase in the ratio-to-GDP of three tenths of a percentage point in 2016, overshooting the target of 24.4% to reach 24.9%. Behaviour within the AR subsector has been fairly heterogeneous, with a decrease in the debt-to-GDP ratio in just three regions: Balearic Islands, Canary Islands and Catalonia. By contrast, higher ratios stand out in Aragón (1 pp), Cantabria (1.1 pp), Extremadura (2.2 pp), Murcia (1.5 pp) and Valencia (1.1 pp).

Debt-to-GDP ratios projected envisaged on the baseline scenario projected by AIReF confirm that only the LCs subsector will reach the reference value foreseen in the Organic Law on Budget Stability and Financial Sustainability by 2020, whereas the rest of subsectors and the GG sector aggregate are not expected to do so for another 20 years. DT-1 establishes a transitional period until 2020 for compliance with the debt limits established for the various sectors: 60% GG, with 44% for CG, 13% for ARs and 3% for LCs. In view of the current stock of debt and the perspectives for the main determinants of debt dynamics for the next few years, LCs are the only subsector likely to comply before 2020 (achieved already in 2016) with this Provision. Overall, the GG debt is not expected to reach 60% of GDP until the year 2037 in the baseline scenario. Regarding the ARs, those most favourably positioned are

Madrid, Navarra and Basque Country, set to reach in 2020 levels close to the reference value stated in the LOEPySF. By contrast, the AR showing the greatest deviation from the reference level for 2020 are Catalonia, Valencia, Murcia and Castilla-La Mancha, which would still need to assign more than 70 additional work days with respect to the reference level. Confirmation of the unlikelihood of compliance with the DT-1 calls for its review, so that it sets paths that are realistic, although demanding, for convergence with the reference levels, in line with paragraph 4 of the DT-1.

Access to extraordinary financing mechanisms under favourable conditions with regard to the market has led to considerable savings in interest for the ARs, with a substantial decrease in implicit rates. Setting up these extraordinary financing mechanisms translated into a substantial improvement to the financing conditions for the assisted ARs. The growing recourse among ARs to the mechanisms (with some exceptions such as Basque Country and Navarra) has given rise to a shift in implicit interest rate spreads for the different ARs with respect to the Treasury, which has moved from positive terrain (50 bps) to a negative position (120 bps) over the last four years. The trend appears to have been reversed in 2016, as the implicit rates in the ARs were seen to approach the financing costs of the National Treasury, reflecting an increase in the cost of the mechanisms in 2016, which reached 0% in 2015. Narrowing interest rate spreads and improving the economic environment would pave the way for a re-setting of funding incentives and to the ARs' gradual return to the market with sustainable debt levels and dynamics.

LCs reached a positive primary balance in 2012, enabling both the reduction of their debt and a significant accumulation of financial assets, among which deposits deserve special mention. The fiscal consolidation process experienced as of 2012 has contributed to a structural change that is visible in the components of the debt dynamics. During the period 08-11, in addition to incurring primary deficits, LCs made use of financial assets and commercial financing, especially to finance the deficit. From 2012, this situation was reversed, 2016 being the fifth consecutive year with a sufficient positive primary balance to pay off the debt, the accumulation of financial assets and to reduce commercial debt. It should be underscored that debt reduction was particularly significant in 2012, in coincidence with the instrumentation of the Payment to Suppliers Program, in which much of the commercial debt of the preceding years was acknowledged.

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

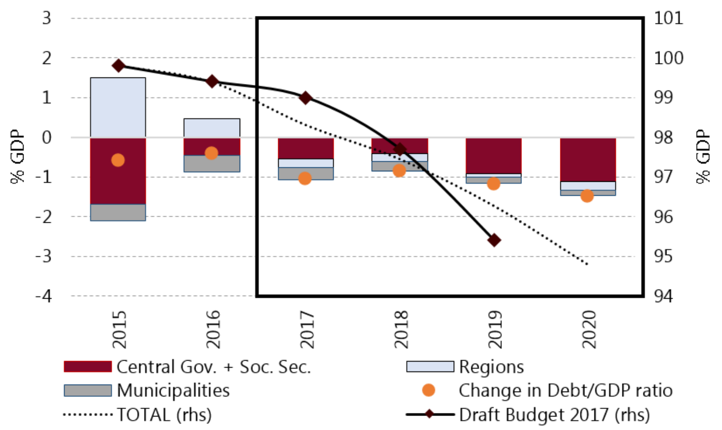
Debt			AIReF Projections				Necessary days per person to cancel debt [3] 2017				Rating [4]			Debt cost 2016		Public financing mechanisms (% debt)	Debt per capita (□)	Fiscal effort indicator S1 [5]
	2007	2016	2017	2018	2019	2020	2017 regional	2017 common	2017 total	Δ 07-17 total	Moody's	S&P	Fitch	Implicit rate	%GDP	2016-IV	2017	2017
General Government [1]	35.5	99.4	98.3	97.4	96.3	94.8	-	-	-	-	-	-	-	2.6	2.8	-	24,658	-
Central Adm+SSF	27.1	71.6	71.1	70.7	69.8	68.6	-	-	-	-	Baa2 (4) ↔	BBB+ (4) ↔	BBB+ (4) ↔	2.9	2.4	-	0	-
Local Corporations	2.7	2.9	2.6	2.3	2.2	2.0	-	-	-	-	-	-	-	1.9	0.1	22.3	0	-
Total Regions [2]	5.7	24.9	24.6	24.4	24.3	24.1	-	-	-	-	-	-	-	1.7	0.4	53.7	6,180	-
ANDALUCIA	4.8	22.5	22.3	22.2	22.3	22.1	81	367	448	289	Baa3 (4) ↑	BBB (4) ↔	BBB- (4) ↔	1.4	0.3	67.6	4,098	0.1
ARAG□N	3.4	21.6	22.0	22.3	22.9	23.3	80	246	326	214	-	BBB- (4) ↔	-	2.4	0.5	33.4	6,042	0.6
P. DE ASTURIAS	3.2	18.9	19.1	18.6	17.2	16.3	70	309	379	248	-	-	BBB (4) ↔	1.8	0.3	35.3	4,163	-0.1
ILLES BALEARS	6.9	30.1	29.1	28.1	28.0	27.7	106	258	364	237	-	BBB (4) ↑	-	1.5	0.4	68.1	7,593	0.5
CANARIAS	3.7	16.0	15.5	14.4	13.9	13.6	57	324	381	244	-	BBB+ (4) ↔	BBB- (4) ↔	1.2	0.2	65.2	3,226	-0.2
CANTABRIA	3.4	23.0	23.4	23.5	23.8	23.8	85	301	386	258	-	-	BBB (4) ↔	1.8	0.4	64.6	5,249	0.1
CASTILLA Y LE□N	3.4	20.4	20.2	19.6	19.1	18.4	74	284	358	228	Baa2 (4) ↔	-	-	2.2	0.4	18.1	4,782	0.1
CASTILLA □LA MANCHA	4.7	37.0	36.6	36.4	36.3	36.0	134	348	482	330	Ba2 (5) ↔	-	BBB- (4) ↔	1.4	0.5	69.5	7,090	1.0
CATALU□A	7.8	35.4	35.2	35.2	35.3	35.1	128	225	353	232	Ba3 (5) ↓	B+ (6) ↓	BB (5) ↔	1.5	0.5	66.6	10,570	1.0
EXTREMADURA	4.5	22.9	23.7	24.6	25.5	26.2	86	398	484	306	Baa3 (4) ↔	BBB (4) ↔	-	2.4	0.5	45.5	4,010	0.7
GALICIA	6.6	18.7	18.4	17.8	17.1	16.2	67	301	368	217	Baa2 (4) ↔	BBB+ (4) ↔	-	2.5	0.4	31.2	4,116	0.3
COMUNIDAD DE MADRID	5.2	14.4	14.1	13.8	13.7	13.3	51	197	249	146	Baa2 (4) ↔	BBB+ (4) ↔	BBB (4) ↔	2.6	0.4	6.3	4,828	-0.2
REGI□N DE MURCIA	2.3	29.1	30.1	31.4	33.2	34.8	110	333	443	304	Ba2 (5) ↔	-	BBB- (4) ↔	1.5	0.4	77.8	6,089	1.4
C. FORAL DE NAVARRA	3.6	18.2	17.2	15.9	14.2	13.4	63	217	280	178	-	A (3) ↔	-	3.3	0.6	-	5,367	-0.2
PA□S VASCO	1.0	14.5	14.3	14.0	13.5	13.3	52	203	256	166	Baa1 (4) ↔	A (3) ↑	BBB+ (4) ↔	1.9	0.3	-	4,762	-0.2
LA RIOJA	3.5	18.5	18.2	18.2	18.0	17.7	67	251	318	203	-	-	BBB (4) ↔	0.6	0.1	18.3	4,900	0.0
COMUNITAT VALENCIANA	11.3	42.5	42.0	41.7	41.7	41.5	153	301	454	292	Ba2 (5) ↔	BB (5) ↔	BBB- (4) ↔	1.1	0.4	76.6	9,421	1.3

Source: INE, IGAE, Bank of Spain, DatosMacro.com and AIReF estimates (baseline 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, the corresponding regional nominal GDP 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, 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 for year-end 2016. Cut-off date 5 April 2017.

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

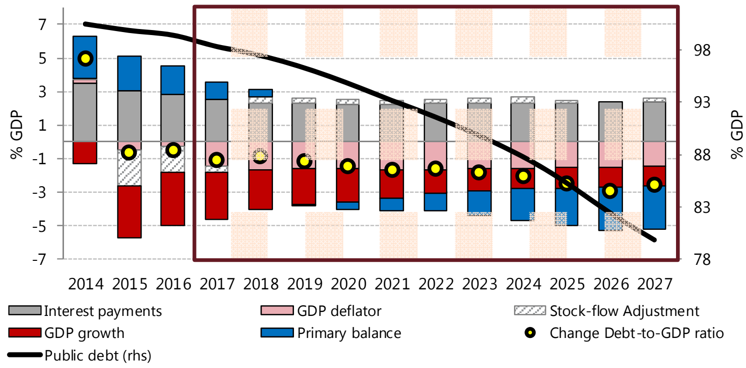


- At year-end 2016 the debt-GDP ratio for the General Government sector reached 99.4%.
- According to the 2017 General State Budget, this ratio would diminish four pp in the period 2016-2019, in line with the neutral path forecast by AIReF.
- As of 2017, it is expected that the Autonomous Regions will contribute slightly to decrease the debt ratio, although the bulk of the adjustment will be borne by the General Government sector together with the Social Security Funds (ACS), especially after 2019.

Source: INE, IGAE, Bank of Spain, Ministry of Economy, Industry and Competitiveness, and estimates by AIReF.

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

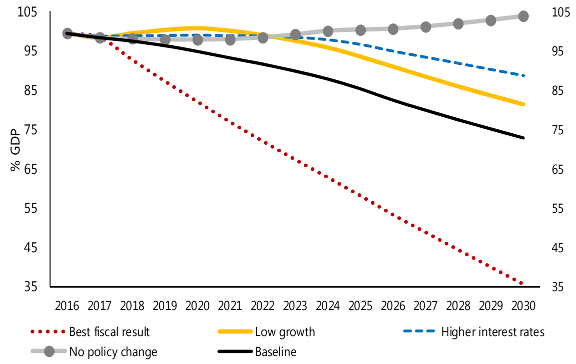
DEBT DYNAMICS AND ITS DETERMINANTS, BASELINE SCENARIO (% GDP)



- The slowing dynamic seen in 2016 continues, but is clearly insufficient to reach 60% of GDP by 2020, as stipulated in DT-1 in the LOEPySF.
- Improvement to the primary balance will increasingly contribute to reducing the ratio as of the year 2019.
- The denominator effect is greater than the interest burden since 2015. Interest rates similar to those experienced during 2008-2012 would revert the situation as of 2019.
- Macro-financial disruptions would not be enough to alter the decreasing path, despite delaying the achievement of targets. Assumptions regarding primary balance are key to future fiscal sustainability.
- Mechanisms such as the Regional Liquidity Fund have substantially reduced the cost of financing debt for ARs.

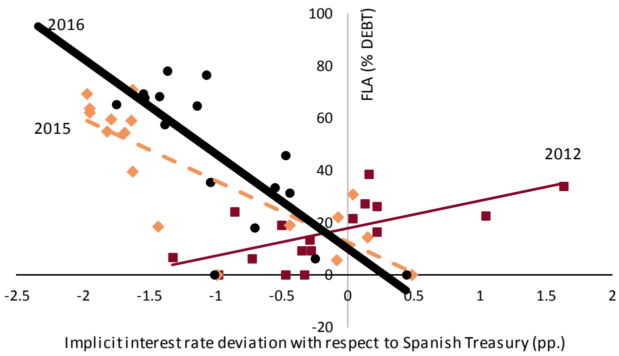
Source: INE, IGAE, Bank of Spain and AIReF estimations.

DEBT DYNAMICS UNDER DIFFERENT SCENARIOS (% GDP)



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

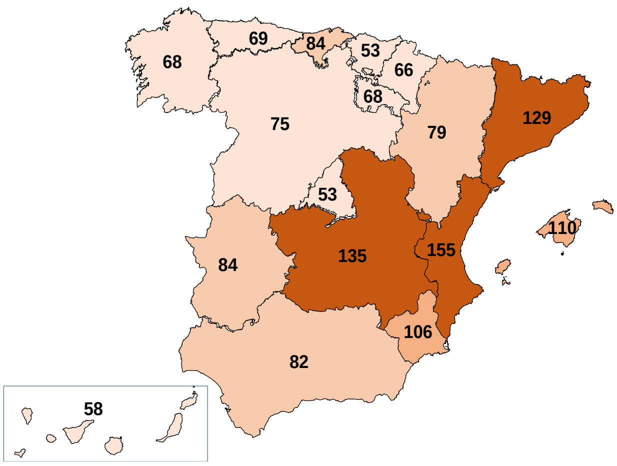
IMPLICIT RATES COMPARED WITH ACCESS TO FLA, ARs 2012-2016



Source: Bank of Spain.

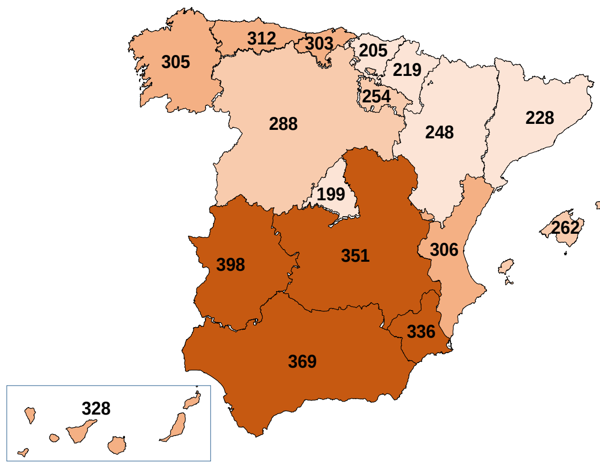
CHARTS 5 AND 6. REGIONAL DEBT INDICATORS PER INHABITANT (NUMBER OF DAYS)

WORKING DAYS NEEDED TO REPAY REGIONAL DEBT (2016)



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

WORKING DAYS NEEDED TO REPAY COMMON DEBT (2016)

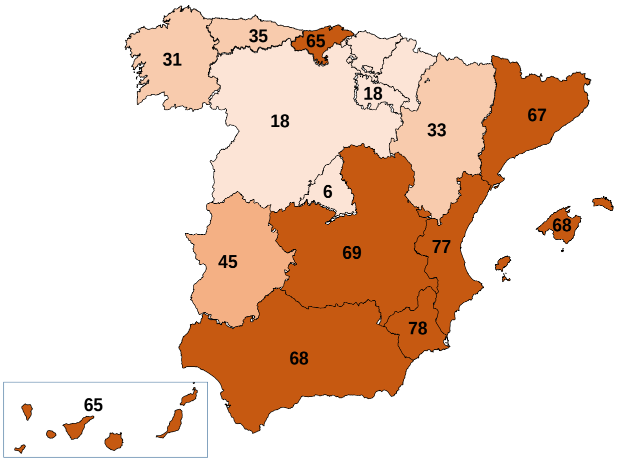


Source: INE, IGAE, Bank of Spain and AIReF estimations.

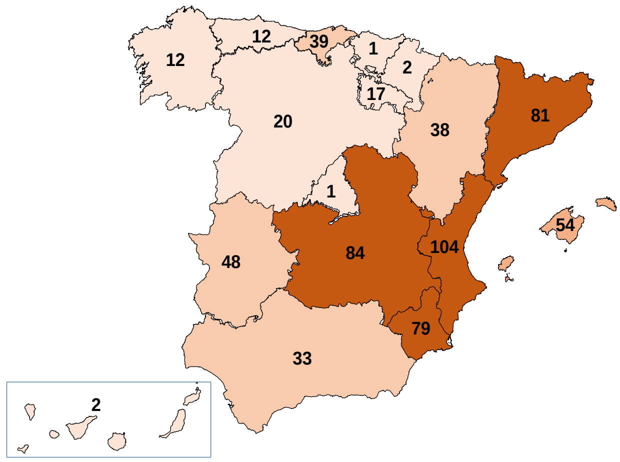
Note: The number of days per person required to repay the debt, in the regional case, derives from multiplying by 365 the ratio of debt to the respective regional GDP. Common debt (Central Government and Social Security Funds plus the Local Corporations subsector) is distributed among the regions according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

CHARTS 7, 8 AND 9. DEPENDENCE ON STATE FUNDS AND ACHIEVEMENT OF THE REFERENCE LEVEL OF DEBT

FINANCING MECHANISMS AS % OF REGIONAL DEBT (2016)



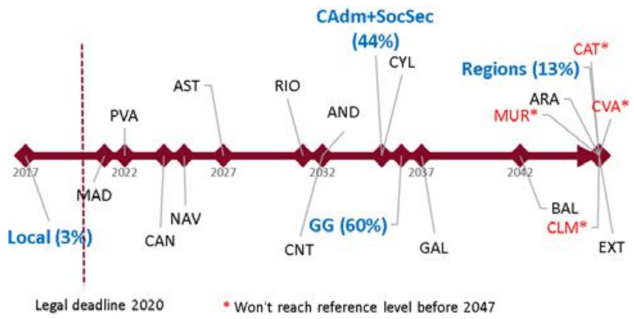
ADDITIONAL WORKING DAYS, IN 2020, WITH RESPECT TO THE REFERENCE LEVEL



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

Note: The additional working days in 2020 are calculated by multiplying by 365 the excess debt in 2020, as a percentage of regional GDP, from the reference value of 13%.

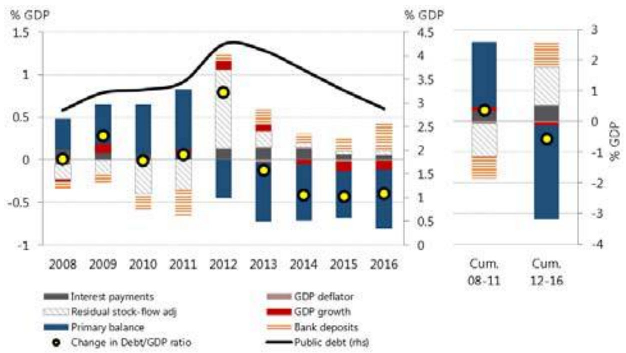
DEBT-TO-GDP REFERENCE LEVEL - YEAR OF ACHIEVEMENT



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

- BAL, CAT, CVA, MUR and CLM require a greater number of working days per person to repay their regional debt. In addition, the scope of the 2020 reference value of 13% requires a greater effort in comparison with the other ARs.
- If within each region the number of working days per person needed to repay the corresponding fraction of common debt is calculated, the result is a number exceeding 300 days in regions such as AND, AST, CNT, CAN, CLM, CVA, GAL, EXT and MUR.
- AIReF's baseline scenario projections show that neither the ARs nor the CA+SSF will achieve the reference level in 2020, as required in DT-I of the LOEPySF. However, in MAD, NAV and PVA a more favourable situation reigns, making compliance possible on a baseline scenario one or two years after the legal deadline.
- The LCs reached the reference level (3%) in 2016 and it is estimated that the General Government sector will not reach a level of debt below 60% of GDP before 2037.

CHART 10. DETERMINANTS OF DEBT IN THE LOCAL CORPORATION SUBSECTOR



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

- Overall, debt dynamics in the subsector present a profile free from major sustainability risks.
- Nevertheless, there is considerable heterogeneity among the various LCs, some of which present large sustainability risks. It is estimated that almost 4/5 of the total debt in the LCs with a debt to consolidated current income ratio above 110% is concentrated in municipalities located in AND, MAD, ARA and CAT to a lesser degree.
- The fiscal consolidation process experienced started in 2012 contributed to a structural change in the main drivers of debt dynamics. During the period 08-11, LCs financed primary deficits partly by recurring to financial assets and commercial debt. However, as of 2012 this situation started to reverse. 2016 was the fifth consecutive year with a sufficient positive primary balance to pay off the debt and accumulate of financial assets.