Independent Authority for Fiscal Responsibility

Public Debt Monitor, June 2017

I. EXECUTIVE SUMMARY

The debt-to-GDP ratio for General Government (GG) was 100.4% in the first quarter of 2017, one percentage point above the end of 2016, although eight tenths below the first quarter of 2016. Data published by the Bank of Spain for the first quarter of 2017 put the debt-to-GDP ratio for GG at 100.4% (€1,128.72 million), 1 point higher than 2016. On a year-to-year basis, outstanding debt increased by € 31.86 million since the first quarter of 2016, although the debt-to-GDP ratio has fallen by eight tenths.

By disaggregating the debt performance by sub-sector, first quarter growth is concentrated in Central Government (CG) and Social Security Funds (SSF) group, while Local Governments (LG) and the Autonomous Regions (ARs) subsector has reduced their ratio. In the first quarter of 2017, the CG and SSF group reached a debt-to-GDP ratio of 72.8%, 1.2 points above the previous quarter. The LG and Regional subsector ratio was marginally corrected (0.1 point), standing at 2.8% GDP (€31.57 million) and 24.8% (24.9% at end of 2016), respectively. On a year-to-year basis, the ARs were the only subsector whose debt increased in relation to first quarter 2016 (€13.3 million, or three tenths GDP). Within the LG subsector, the main corrections with regard to 2016 occurred in the Comunitat Valenciana and Andalucia, while Galicia, Comunidad Foral de Navarra and, to a lesser extent, Extremadura, stand out for their inter-quarter growth. As for the Canary Islands, whose ratio has not varied in either inter-quarter or inter-annual terms, the Fitch rating agency improved its credit rating to BBB.

The debt forecasts contained in the last Stability Program Update (SPU) confirm non-compliance with the First Transitory Provision of the Law on Budget Stability and Financial Sustainability (LOEPySF). According to the 2017 SPU, the debt-to-GDP ratio will be 98.8% at the end of 2017. This would again breach the provisions of point 1.a) of the First Transitory Provision of the LOEPySF 2/2012, regarding a decrease of at least 2 percentage points of the debt-to-GDP ratio when the real GDP or employment growth rate exceeds 2% annually, given the most recent forecasts for both variables. The SPU also forecasts a drop of 7 points during the 2017-2020 period, which is insufficient to reach the reference value of 60% GDP established in the First Transitory Provision. The SPU debt forecasts seem to become more optimistic as the forecast horizon increases, taking into account AIReF's forecasted confidence intervals, which reflect a 70% probability of ending with more debt than projected in the SPU through 2020.

AIReF's neutral scenario anticipates the achievement of the reference values listed in the LOEPySF for the GG within 20 years. AIReF's projected neutral scenario, which forecasts a downward trend, albeit with a moderate correction, which would delay the achievement of the 60% GDP reference value for the GG until 2037. At the Regional level, the best performing communities are CAN, MAD and PVA, which would reach a level close to the LOEPySF reference value by 2020 (13% of GDP). On the contrary, other regions, namely CAT, MUR, CVA and CLM, would not reach the reference level in the next 30 years under the assumptions of the neutral scenario. Only LGs subsector has been able to reach the reference value as early as 2016. As mentioned above, 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.

Access to state funding mechanisms begins to slow. Since the beginning of 2016, there has been a decrease in the growth rate of the stock of financing mechanisms for the whole ARs subsector (from a y-o-y rate above 42% in Q1-2015 to 17% in Q1-2017). This is more evident if we only consider access to the Regional Liquidity Fund (FLA), since some Regions have chosen to access the Flexible Credit Lines mechanism (FCL), which represents a little more than 10% of the total. This has been possible, in part because of the regional deficit corrections as a whole, and also because of increasing access to the market (although incipient). In relative terms, the share of public financial assistance to the regions as part of their total debt falls for the first time from quarter to quarter since its introduction in mid-2012. However, at the individual level the behavior is very heterogeneous. On the one hand, there are regions that have seen significant y-o-y increases in the use of these instruments as a percentage of debt (especially GAL, EXT, ARA and CNT). On the other hand, other regions such as when considering other regions such as AST, CYL, MAD and RIO, the latest published data shows a slight decrease for the same period. This access to the mechanisms still assumes an attenuating factor in regional financing costs and a de facto floor in terms of their credit rating.

During 2017 most large cities plan to continue amortizing debt with part of the primary balances generated, as they have been doing since 2012. The number of cities with populations greater than 250 thousand and a debt-to-current consolidated revenue (CCR) ratio over 110% has declined over the past four years from four to only one (Zaragoza). Due to the joint effect, on the one hand, from the ceiling imposed by applying the expenditure rule to growth and, on the other, from the recovery of income, the majority of the large cities are expected to continue generating financing capacity that will allow them to reduce the debt-to-CCR revenue ratio in 2017. However, some cities, such as Las Palmas GC, and to a lesser extent, Barcelona, Valladolid and Zaragoza, expect their debt-to-CCR ratio to increase in 2017.

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

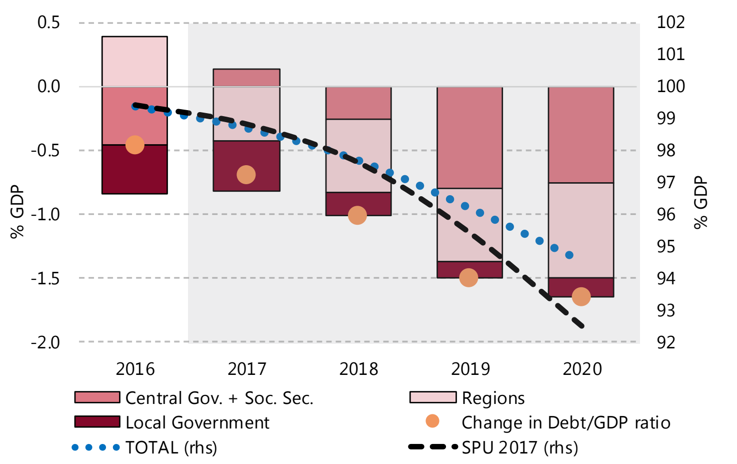
Debt	2007	2016	2017q1	AIReF Proyections 2017	AIReF Proyections 2018	AIReF Proyections 2019	AIReF Proyections 2020	Necessary days per person to cancel debt [3] 2017: 2017 regional	2017 common	2017 total	Δ 07-17 total	Rating [4]: Moody's	S&P	Fitch	Debt cost 2016: Implicit rate	%GDP	Public financing mechanisms (% debt) 2017-I	Debt per capita (€) 2017	Fiscal effort indicator S1 [5] 2017
General Government [1]	35.5	99.4	100.4	98.7	97.7	96.2	94.5	-	-	-	-	-	-	-	2.4	2.5	-	24,769	-
Central Adm+SSF	27.1	71.6	72.8	71.8	71.5	70.7	70.0	-	-	-	-	Baa2 (4) ↔	BBB+ (4) ↔	BBB+ (4) ↔	2.6	2.1	-	0	-
Local Corporations	2.7	2.9	2.8	2.5	2.3	2.2	2.0	-	-	-	-	-	-	-	1.9	0.1	22.2	0	-
Total Regions [2]	5.7	24.9	24.8	24.4	23.9	23.3	22.6	-	-	-	-	-	-	-	1.5	0.4	53.5	6,133	-
ANDALUCIA	4.8	22.5	21.6	22.2	21.9	21.3	20.6	81	369	451	292	Baa3 (4) ↔	BBB (4) ↔	BBB- (4) ↔	1.3	0.3	67.7	4,091	0.0
ARAGÓN	3.4	21.6	21.9	21.8	21.9	22.4	22.9	80	248	328	216	-	BBB- (4) ↔	-	2.1	0.4	33.5	5,967	0.3
P. DE ASTURIAS	3.2	18.9	19.3	18.8	18.6	18.7	18.7	69	311	380	248	-	-	BBB (4) ↔	1.1	0.2	33.9	4,117	0.0
ILLES BALEARS	6.9	30.1	30.4	28.6	26.8	25.5	23.8	104	259	364	237	-	BBB (4) ↔	-	0.8	0.2	66.4	7,506	0.2
CANARIAS	3.7	16.0	16.0	15.0	13.4	11.6	9.8	55	327	382	245	-	BBB+ (4) ↔	BBB (4) ↑	1.1	0.2	66.7	3,130	-0.6
CANTABRIA	3.4	23.0	22.7	23.5	23.5	23.5	23.3	86	304	390	262	-	-	BBB (4) ↔	1.5	0.3	64.6	5,267	0.2
CASTILLA Y LEÓN	3.4	20.4	20.2	20.3	20.1	20.2	20.1	74	287	361	231	Baa2 (4) ↔	-	-	1.9	0.4	18.2	4,811	0.0
CASTILLA –LA MANCHA	4.7	37.0	36.5	36.6	36.2	36.1	35.7	134	353	487	335	Ba2 (5) ↔	-	BBB- (4) ↔	1.4	0.5	68.5	7,056	1.0
CATALUÑA	7.8	35.4	35.2	34.9	34.2	33.4	32.4	127	227	355	234	Ba3 (5) ↔	B+ (6) ↔	BB (5) ↔	1.5	0.5	67.1	10,449	0.7
EXTREMADURA	4.5	22.9	23.6	23.4	24.4	25.1	25.3	85	399	485	306	Baa3 (4) ↔	BBB (4) ↔	-	1.6	0.3	44.9	3,980	0.4
GALICIA	6.6	18.7	19.8	18.7	18.4	18.3	17.9	68	304	372	221	Baa2 (4) ↔	BBB+ (4) ↔	-	1.8	0.3	37.3	4,173	-0.1
COMUNIDAD DE MADRID	5.2	14.4	14.9	14.2	13.7	13.1	12.3	52	198	250	147	Baa2 (4) ↔	BBB+ (4) ↔	BBB (4) ↔	2.3	0.3	6.1	4,880	-0.3
REGIÓN DE MURCIA	2.3	29.1	28.8	29.5	29.5	29.6	29.6	108	334	442	303	Ba2 (5) ↔	-	BBB- (4) ↔	1.3	0.4	75.9	5,993	0.9
C. FORAL DE NAVARRA	3.6	18.2	19.1	18.2	17.3	16.4	15.5	66	218	284	183	-	A (3) ↔	-	2.4	0.4	-	5,678	-0.2
PAÍS VASCO	1.0	14.5	15.1	13.0	12.9	12.9	12.7	48	205	252	163	Baa1 (4) ↔	A (3) ↔	BBB+ (4) ↔	1.6	0.2	-	4,331	-0.3
LA RIOJA	3.5	18.5	19.1	17.9	17.6	17.5	17.2	65	252	318	203	-	-	BBB (4) ↔	0.3	0.0	17.6	4,837	-0.2
COMUNITAT VALENCIANA	11.3	42.5	41.5	41.6	40.1	38.8	37.4	152	303	455	293	Ba2 (5) ↔	BB (5) ↔	BBB- (4) ↔	1.0	0.4	77.2	9,351	1.1

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, 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 1st quarter 2017. Latest data from 17th June, 2017.

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

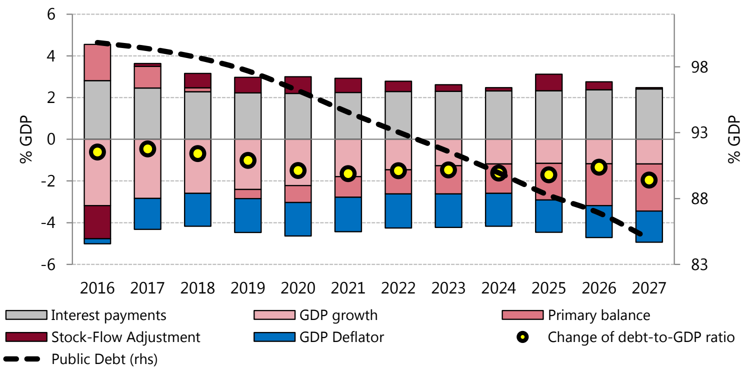


- The latest data published by the Bank of Spain put the 2017Q1 debt at 100.4% of GDP. In relation to 2016Q1, there has been a decrease of almost one percentage point, explained by a decrease in the CG and to a lesser extent by the LGs debt-to-GDP ratios. The Regional debt ratio increased slightly with respect to 2016Q1. According to the 2017 SPU, this ratio would decrease 7 p.p. during 2017-2020, 40% more than what is predicted in AIReF's neutral scenario.
- AIReF's neutral scenario projects all subsectors to contribute to the reduction of the debt ratio in the next 4 years, with almost half the reduction due to the evolution of the regional subsector.

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

GRAPH 2, 3 & 4. EVOLUTION OF THE DEBT-TO-GDP RATIO AND SENSITIVITY ANALYSIS

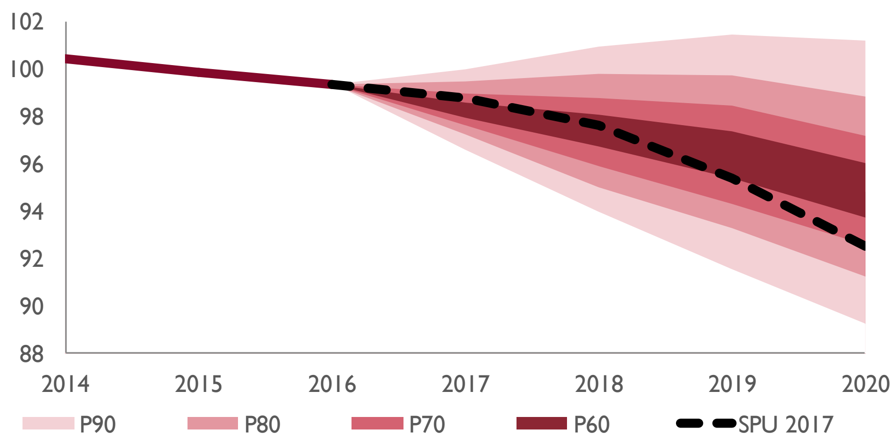
DYNAMICS OF THE DEBT AND DETERMINANTS, NEUTRAL SCENARIO (% GDP)

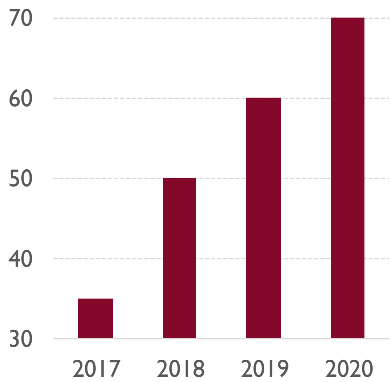


Source: INE, IGAE, Bank of Spain and AIReF projections

- The neutral scenario projects a decreasing path over the next 10 years. Beginning in 2019, the rate of debt decline is close to 2 p.p. of GDP.
- As for factors that explain the evolution of debt, the deceleration of economic growth is offset by a gradual improvement in the primary balance. On the other hand, the interest burden remains relatively constant at 2% of GDP, as the relative decline in the debt level is counterbalanced by a gradual increase in the interest rates on government debt.
- Moderate macro-financial disturbances are not sufficient to substantially affect debt dynamics, but if the fiscal consolidation process is halted, sustainability may be compromised.
- The SPU's debt forecasts for the GG becomes optimistic as the forecast horizon increases.

DYNAMICS OF DEBT AND CONFIDENCE INTERVALS



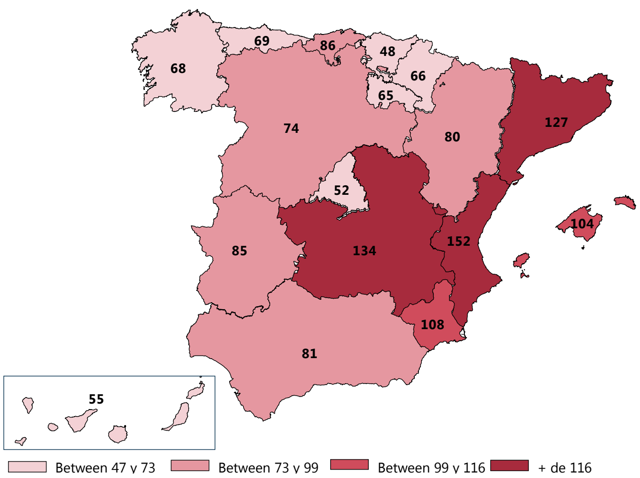


Probability of a debt-to-GDP ratio higher than in SPU 2017

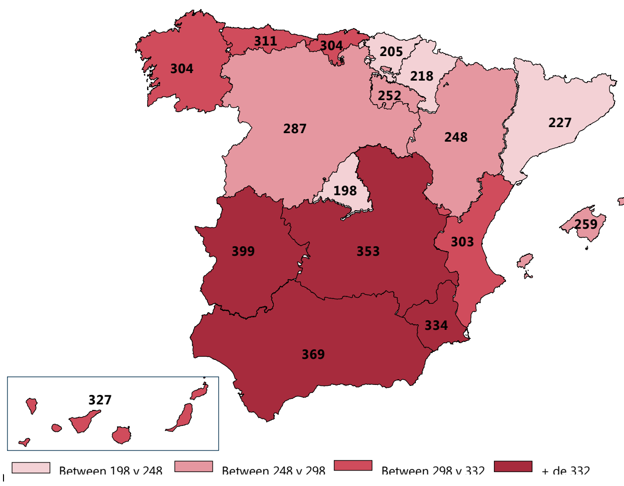
Source: INE, IGAE, Bank of Spain and AIReF projections

GRAPHS 5 & 6. REGIONAL DEBT INDICATORS PER PERSON (NUMBER OF DAYS)

WORKING DAYS NEEDED TO REPAY REGIONAL DEBT (2017)



WORKING DAYS NEEDED TO REPAY THE COMMON DEBT (2017)

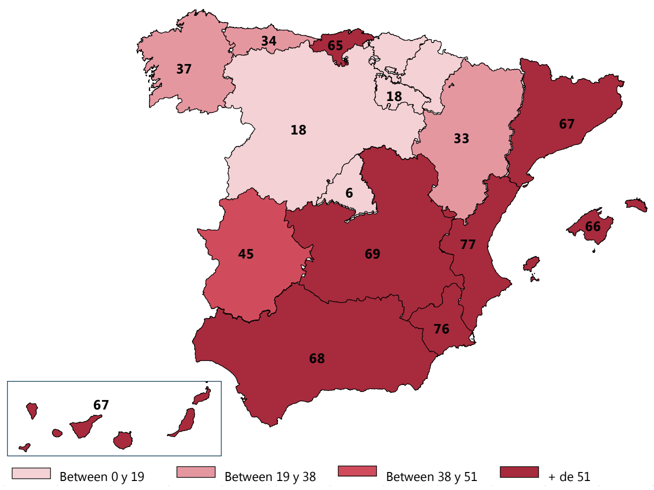


Sources: INE, IGAE, Bank of Spain and AIReF projections

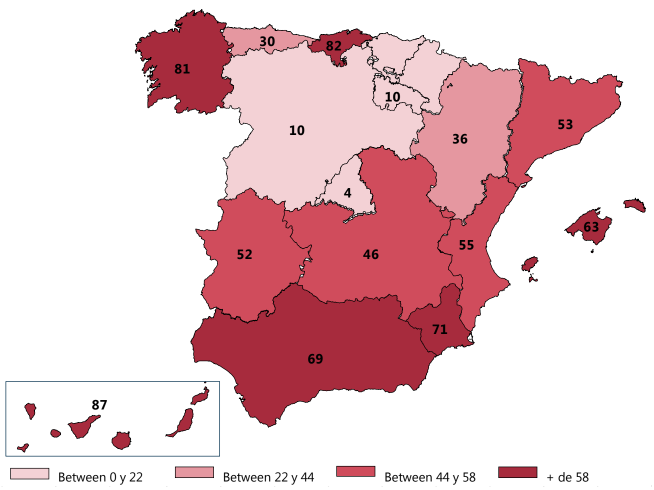
Note: The number of days per person required to repay the debt, in the regional case, derives from multiplying by 365 the ratio of debt to the respective regional GDP. Common debt (Central Government and Social Security Funds plus the Local Corporations subsector) is distributed among the regions according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

GRAPHS 7, 8 & 9. STATE FINANCING DEPENDENCE

FINANCING MECHANISMS AS % OF REGIONAL DEBT (2017Q1)

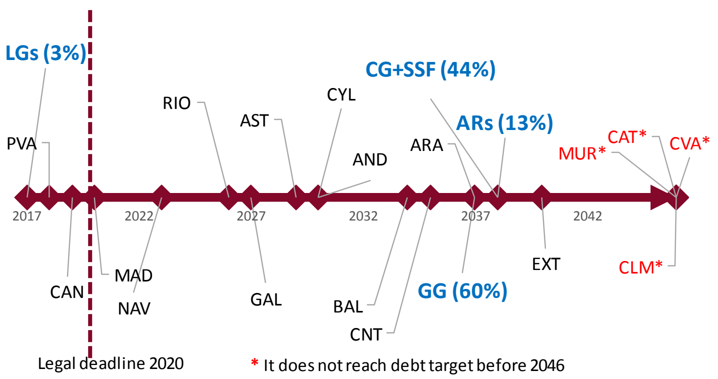


FINANCING MECHANISMS AS % OF REGIONAL DEBT (2020)



Sources: INE, IGAE, Bank of Spain and AIReF projections

DEBT-TO-GDP REFERENCE LEVEL-YEAR OF ACHIEVEMENT

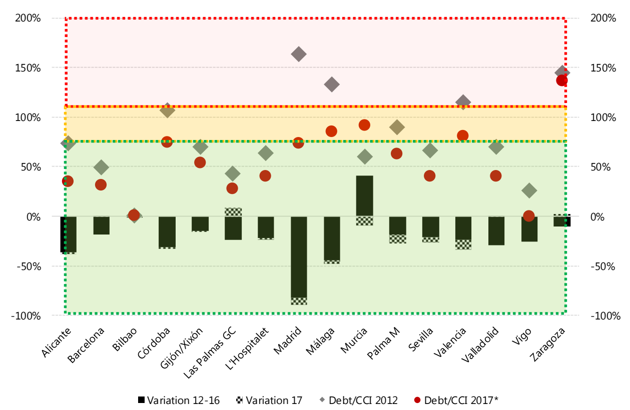


Sources: INE, IGAE, Bank of Spain and AIReF projections

- By 2017, on average, a person in Spain would need to allocate 86 working days to amortize the entire regional debt. In PVA or MAD, that figure is around 50 days, whereas in CAT, CLM and CVA, it is three times higher. Inhabitants in EXT, AND, CLM and MUR need to allocate approximately one year of work to amortize the fraction of the common debt that would correspond to them, being in the upper quartile.
- In MUR, CVA, AND, CNT, BAL, CAT and CLM, the State financing mechanisms account for more than 60% of the regional debt. It is projected that there will be a slight decrease in the use of these types of instruments by 2020, although there are major regional divergences.
- In the neutral scenario, only PVA, CAN and MAD will reach the reference level before 2020 (the EELL did it already in 2016), as established by the DTI of the LOEPySF. Others, such as NAV will do so a few years after the legal deadline. AIReF projects the GG to fail reaching a debt level below 60% GDP before 2037.

GRAPH 10. DETERMINANTS OF LOCAL GOVERNTMENT SUBSECTOR DEBT

EVOLUTION OF DEBT/ICC RATIO



- The debt/CCR ratio declined dramatically between 2012 and 2016. Madrid is notable for recording a decrease of more than 82 p.p.. , and also Alicante and Malaga, whose ratios have decreased almost 40 points. For 2017, Valencia, Murcia and Palma expect reductions of almost 9 points.
- Las Palmas GC, and to a lesser extent Barcelona, Valladolid and Zaragoza, expect an increase in their 2017 debt/CCR ratio.
- Cities with a debt/CCR ratio greater than 110% have decreased from four to only one, Zaragoza, in the last 4 years. In the last case (and also in Murcia) the value of EDP imputed loans for government investment in trams has been taken into account.

Sources: Cities town halls, Bank of Spain, SGCAL and AIReF projections. **Note:** The 2012 debt/CCR ratio was calculated using data from the last settlement published by the SCFAL (MINHAFP). The data provided by these LGs for the AIReF report on initial 2017 budgets were used for years 2016 and 2017. In 2017, it is reported the official year-end forecast from the local government.