Independent Authority for Fiscal Responsibility

Debt Monitor, December 2017

I. EXECUTIVE SUMMARY

The debt-to-GDP ratio for General Government was 98.7% at the end of the third quarter of 2017, decreasing 1.1 percentage points below the second quarter of 2017. Data published by the Bank of Spain for the third quarter of 2017 and the updated results from the Quarterly Spanish National Accounts (QSNA) by the National Statistics Institute, put the debt-to-GDP ratio for General Government at 98.7% (€1,136.17 million), 1.1% above the previous quarter. On a year-to-year basis, outstanding debt increased by € 27.74 million, although the debt-to-GDP ratio has fallen by 1.2 percentage points.

By disaggregating the quarterly debt performance by sub-sector, it can be observed that debt-to-GDP ratio decreased in the Central Government (CG), Autonomous Regions (AR) and Local Governments (LG). In the third quarter of 2017, the CG and SSF group reached a debt-to-GDP ratio of 71.3% (€ 821.2 million), 0.6% below the previous quarter. The AR debt ratio fell by 0.4%, thereby suffering the greatest quarterly decrease recorded in the last 20 years, reaching 24.7% of Spanish GDP (€284.41 million), while for the LG sub-sector the ratio fell slightly to 2.7% of GDP (€30.56 million). As regards the ARs, the ratio decline of almost one percentage point observed in Principado de Asturias, La Rioja and Comunitat Valenciana, and at the opposite extreme, the slight increases seen in the regions of Castilla y León and Illes Balears stand out.

Despite the recent upward evolution of the ratio with a correction of 2 percent compared to the maximum achieved at the start of 2016, the AIReF's baseline scenario continues to project the achievement of the reference values listed in the LOEPySF for the GG will occur after 2030. The AIReF's projected baseline debt scenario forecasts a slightly downward trend, which would delay the achievement of the 60% of GDP reference value for the GG until 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 3 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 baseline scenario. Only the LGs sub-sector 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 has remained unchanged from the previous quarter, while in relation to the ARs, S&P has increased Andalusia's financial solvency rating one level to BBB+.

In the medium term, the evolution of the Central Government's debt path envisaged in the 2018 Budget Plan can be considered probable. The debt forecasts contained in the 2018 Budget Plan are in line with AIReF's central forecasts in the 2017-2020 period. The probability of achieving a debt-to-GDP ratio greater than that forecasted in 2017 is moderately low, although the likelihood increases as the time horizon is extended, reaching approximately 60% in 2020. Deterioration of macro-financial conditions may result in a risk to debt sustainability, although the main determinant factor in the medium term continues to be the correction of the structural deficit and the generation of primary surpluses.

The risks to financial sustainability in the medium term for the AR sub-sector are high, although they have decreased slightly throughout 2017. Given the high starting level of the sub-sector's debt (close to 25% of GDP), which delays achievement of the reference level of 13% of GDP to 2037 in the baseline scenario, the sub-sector sustainability risks are considered high. It should be noted that, throughout 2017, these risks have decreased slightly due to the contribution of three main factors: (I) improvement of the economic environment; (ii) the moderate development in financing costs (supported by the favourable conditions of financing mechanisms); and (iii) the forecasted gradual correction of the sub-sector deficit with feasible achievement of the stability objective for 2018. The AIReF's analysis categorises the aggregate sustainability risk level into 6 levels (from low to very high), drawing on 5 main factors or dimensions: (i) level of indebtedness; (ii) debt flows, associated with the evolution of the budget balance; (iii) repayment capacity, which represents the importance of current income; (iv) available tax space and (v) overall economic conditions, including the labour market situation. In this framework the ARs present a mixed picture, with Catalonia, Castilla-La Mancha, the region of Murcia and Comunitat Valenciana standing out with a very high risk. Extremadura and Andalucía are situated two levels down and in third place Aragón and Illes Balears present a medium risk level. Cantabria and Castilla y León have a moderately low risk level, as is the case for Asturias and Galicia. Finally, Navarra and La Rioja present low sustainability risks, along with the Canary Islands, Madrid and Basque Country.

The weight of extraordinary financing mechanisms on the ARs has been increasing both in absolute terms (reaching €159,526 million in outstanding loans in the third quarter of 2017) and in relative terms, as they represent 56.1% of the regional sub-sector's total debt. The weight of financing mechanisms is increasingly significant for the ARs, although their distribution is uneven regionally and, for eight regions, represents more than two thirds of their total debt. In absolute terms, recourse to financing mechanisms has also been inconsistent for the various ARs as 70% of the overall debt of the Autonomous Region Financing Fund (FFCCAA) belongs to three regions, Catalonia (33% of the total), Comunitat Valenciana (22%) and Andalusia (15%). Alongside Castilla La Mancha, the first two are also the most indebted in relation to their GDP.

At the end of the third quarter of the year, the public debt net of bank deposits decreased to 0.6% of GDP in the LG sub-sector. After declining below 3% of 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 important primary balances recorded by the sub-sector are being used to increase bank deposits instead of amortizing debt. Since the end of 2012, LG deposits have almost doubled in terms of GDP (2%), exceeding € 23 million. Accordingly, the net debt of liquid financial assets falls to 0.6% of GDP.

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

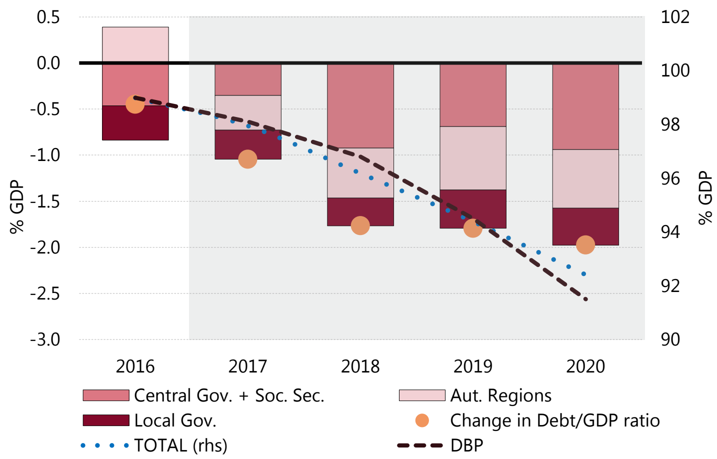
Debt							AIReF Projections				Necessary days per person to repay debt 3) 2017				Rating 4)			Debt cost 2016		Public financing mechanisms (% debt)	Debt per capita (□)	Debt / Current Revenue (%) 5)	GFN / Current Revenue (%) 6)	Fiscal effort indicator S1 7)
	2007	2013	2014	2015	2016	2017 III	2017	2018	2019	2020	2017 regional	2017 common	2017 total	Δ 07-17 total	Moody's	S&P	Fitch	Implicit rate	%GDP	2017 - III	2017	2017 - III	2017	2017
General Government 1)	35.6	95.5	100.4	99.4	99.0	98.7	97.9	96.2	94.4	92.4	-	-	-	-	-	-	-	2.4	2.5	-	24599	261.6	-	-
Central Adm+SSF	27.2	70.8	73.7	71.8	71.3	71.3	71.0	70.1	69.4	68.4	-	-	-	-	Baa2 (4) ↔	BBB+ (4) ↔	BBB+ (4) ↔	2.7	2.1	-	-	390.8	-	-
Local Corporations	2.7	4.1	3.7	3.3	2.9	2.7	2.6	2.3	1.8	1.4	-	-	-	-	-	-	-	1.9	0.1	22.9	-	46.7	-	-
Total Regions 2)	5.7	20.5	22.9	24.4	24.8	24.7	24.4	23.8	23.2	22.5	-	-	-	-	-	-	-	1.5	0.4	56.1	6125	179.2	25.4	-
ANDALUCIA	4.8	17.8	21.2	21.9	22.4	21.9	22.2	21.8	21.0	20.4	81	366	447	289	Baa3 (4) ↔	BBB+ (4) ↗	BBB- (4) ↔	1.3	0.3	72.1	4096	135.0	26.5	-0.1
ARAG□N	3.4	16.5	18.3	20.5	21.5	21.6	21.5	21.1	21.2	21.6	78	244	323	211	-	BBB- (4) ↔	-	2.0	0.4	41.8	5925	167.6	21.7	0.2
P. DE ASTURIAS	3.2	14.8	16.9	18.1	18.8	18.8	18.7	18.4	18.4	18.5	68	308	376	245	-	-	BBB (4) ↔	1.0	0.2	35.9	4096	110.1	15.8	-0.1
ILLES BALEARS	6.9	27.0	29.7	30.5	30.0	30.8	29.1	27.5	26.2	24.6	106	259	365	238	-	BBB (4) ↔	-	1.2	0.3	70.1	7560	191.3	22.9	0.2
CANARIAS	3.7	13.4	15.2	16.2	16.2	16.6	15.2	13.8	11.9	10.0	56	324	379	243	-	BBB+ (4) ↔	BBB (4) ↔	1.2	0.2	68.1	3170	99.3	6.7	-0.7
CANTABRIA	3.4	18.5	20.3	21.8	22.9	23.1	23.1	22.7	23.0	23.3	84	299	383	255	-	-	BBB (4) ↔	1.4	0.3	71.0	5206	129.8	20.4	0.3
CASTILLA Y LE□N	3.4	16.4	18.0	19.6	20.3	20.4	20.2	19.9	19.8	19.7	74	284	358	228	Baa2 (4) ↔	-	-	1.8	0.4	19.0	4782	140.1	12.2	-0.1
CASTILLA □LA MANCHA	4.7	31.0	36.0	36.2	36.8	36.4	36.5	36.0	35.8	35.7	133	349	482	330	Ba2 (5) ↔	-	BBB- (4) ↔	1.4	0.5	71.8	7063	230.1	32.3	1.0
CATALU□A	7.8	30.1	32.7	35.4	35.3	35.1	34.7	33.8	32.8	31.9	127	224	351	230	Ba3 (5) ↔	B+ (6) ↔	BB (5) ↔	1.5	0.5	69.0	10421	261.8	42.9	0.7
EXTREMADURA	4.5	15.7	18.6	20.6	22.8	23.3	23.1	22.9	23.0	23.2	84	397	481	303	Baa3 (4) ↔	BBB (4) ↔	-	1.5	0.3	48.6	3930	103.5	11.6	0.2
GALICIA	6.6	17.2	18.5	18.5	18.6	18.6	18.8	18.4	18.2	18.0	68	302	370	219	Baa2 (4) ↔	BBB+ (4) ↔	-	1.6	0.3	42.3	4194	117.9	24.1	-0.1
COMUNIDAD DE MADRID	5.2	11.9	13.0	14.1	14.4	14.9	14.3	14.1	13.6	12.9	52	197	249	146	Baa2 (4) ↔	BBB+ (4) ↔	BBB (4) ↔	2.3	0.3	5.9	4891	138.1	16.5	-0.2
REGI□N DE MURCIA	2.3	20.9	25.7	27.5	29.0	29.2	29.4	29.2	28.8	28.6	107	332	439	300	Ba2 (5) ↔	-	BBB- (4) ↔	1.4	0.4	78.8	5960	188.4	27.1	0.6
C. FORAL DE NAVARRA	3.6	17.9	17.9	17.9	18.1	19.0	18.0	17.8	17.6	18.5	66	216	281	180	-	A (3) ↔	-	2.4	0.4	-	5619	97.1	13.0	0.1
PA□S VASCO	1.0	13.2	13.9	14.2	14.4	14.6	13.0	12.9	12.8	12.8	47	203	250	161	Baa1 (4) ↔	A (3) ↔	BBB+ (4) ↔	1.5	0.2	-	4320	107.8	2.0	-0.2
LA RIOJA	3.5	15.2	17.0	18.1	18.4	18.4	17.9	17.2	16.8	16.4	65	250	315	200	-	-	BBB (4) ↔	0.4	0.1	17.9	4845	127.2	26.3	-0.2
COMUNITAT VALENCIANA	11.3	34.1	38.5	41.3	42.3	40.9	41.5	40.1	38.6	37.0	151	300	451	289	Ba2 (5) ↔	BB (5) ↔	BBB- (4) ↔	0.9	0.4	80.6	9321	274.8	43.4	1.0

Source: INE, IGAE, Bank of Spain, DatosMacro.com and AIReF projections (projections corresponding to the 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 Governments sub-sector), 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)** The current income used are those published by IGAE, in accordance with ESA 2010 methodology. **6)** The current income corresponds to 2016. **7)** S1 indicator is defined as the average primary balance required between 2017 and 2030 to reach the target of 13% of GDP by 2030.

Latest data from 15th December, 2017.

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

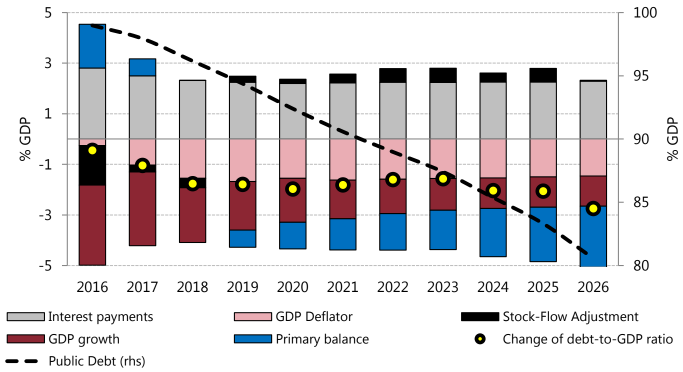


Source: INE, IGAE, Bank of Spain, Ministry of Economy, Industry and Competitiveness and AIReF estimates.

- The latest data published by the Bank of Spain put the 2017Q3 debt at 98.7% of GDP, 1.1% below the figure for 2017Q2.
- In the third quarter of 2017, the CG and SSF group reached a debt-to-GDP ratio of 71.3%, 0.6% below the previous quarter. The AR debt ratio fell by 0.4%, thereby suffering the greatest quarterly decrease recorded in the series, reaching 24.7% of GDP, while for the LG sub-sector the ratio fell slightly to 2.7% of GDP.
- According to the 2018 Budget Plan, this ratio will decrease by 7.5% in the 2017-2020 period, 1% more than that forecasted in the AIReF□baseline scenario.
- The AIReF□baseline scenario envisages that all sub-sectors will contribute to reduce the debt ratio in the next 4 years, with almost half of the decline corresponding to the CG+SSF sub-sector.

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

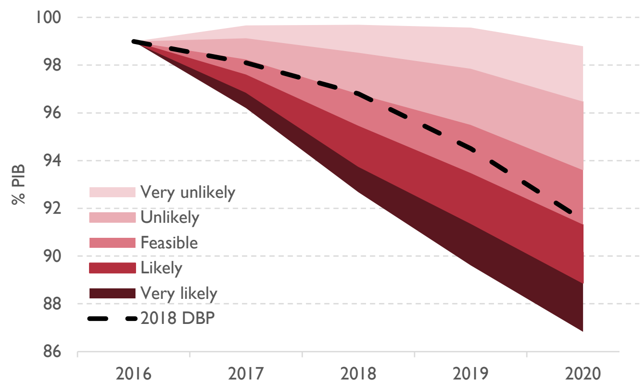
DEBT DYNAMICS AND DETERMINANTS, BASELINE SCENARIO (% GDP)



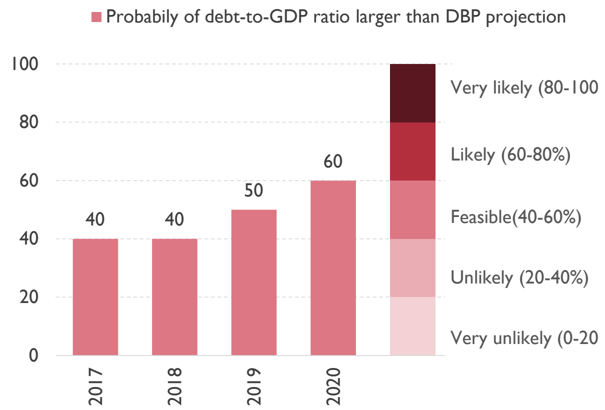
Source: INE, IGAE, Bank of Spain and AIReF estimates.

- The baseline scenario projects a slight but sustained decrease in the debt ratio over the next 10 years, being slightly greater than 80% of GDP in 2026. Achievement of the reference value of 60% of GDP for GG is delayed until 2035.
- The deceleration of economic growth is counterbalanced by a gradual improvement in primary balances. In turn, the interest burden remains relatively stable at around 2% of GDP.
- Moderate macro-financial disturbances do not substantially affect debt dynamics, although if the fiscal consolidation process halts debt sustainability may be compromised.
- The debt projections contained in the 2018 DBP are in line with AIReF's central projections for the 2017-2020 period.

DRAFT BUDGETARY PLAN TARGETS & CONFIDENCE INTERVALS



LIKELIHOOD OF NON-COMPLIANCE

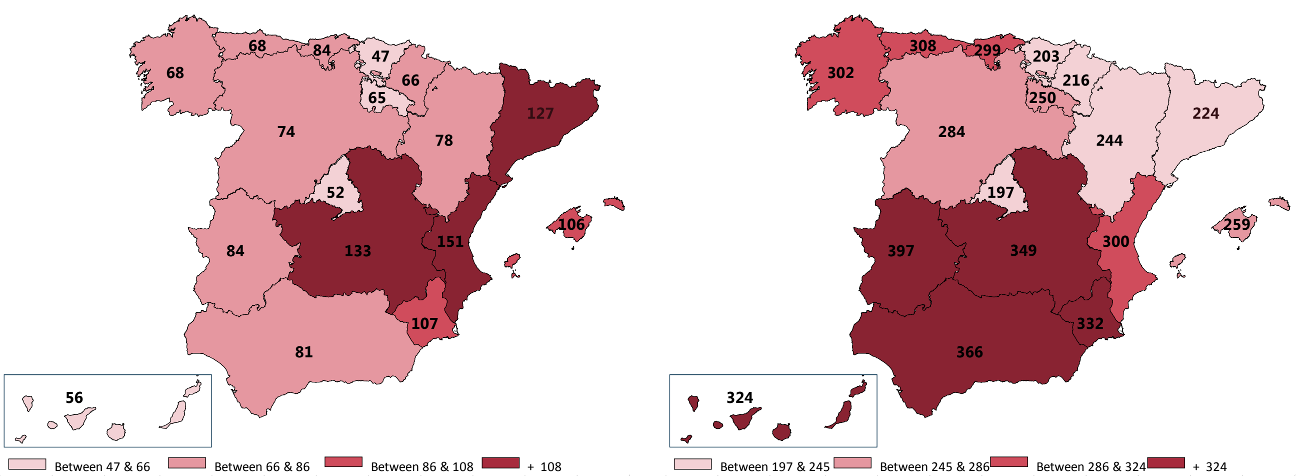


Source: INE, IGAE, Bank of Spain, and AIReF forecasts.

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

NUMBER OF DAYS NEEDED TO REPAY THE AUTONOMOUS REGIONS' DEBT (2017)

NUMBER OF DAYS NEEDED TO REPAY THE COMMON DEBT (2017)

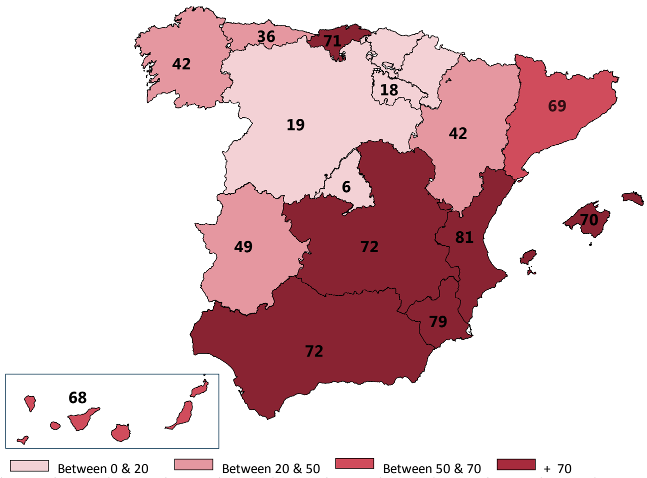


Source: INE, IGAE, Bank of Spain and AIReF estimates

Note: The number of days per person required to repay the debt, in the regional case, results from multiplying by 365 the ratio of such debt to the respective regional GDP. Common debt (Central Government and Social Security Funds plus the Local Governments sub-sector), 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.

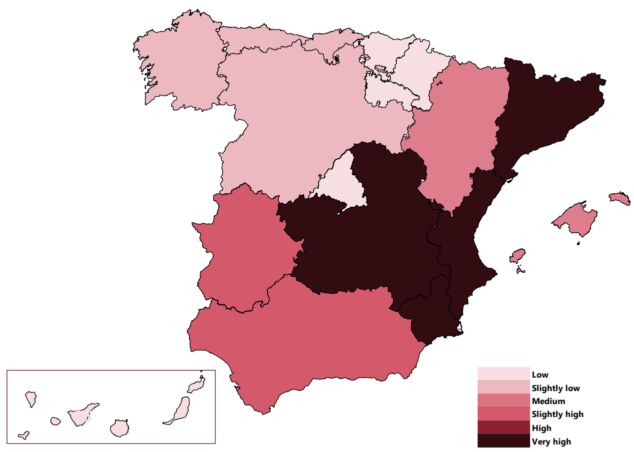
GRAPHS 7, 8 AND 9. PUBLIC FINANCIAL AID AND ESTIMATED YEAR OF ACHIEVEMENT OF THE REFERENCE LEVEL

PUBLIC FINANCING MECHANISMS AS % OF REGIONAL DEBT (2017Q3)



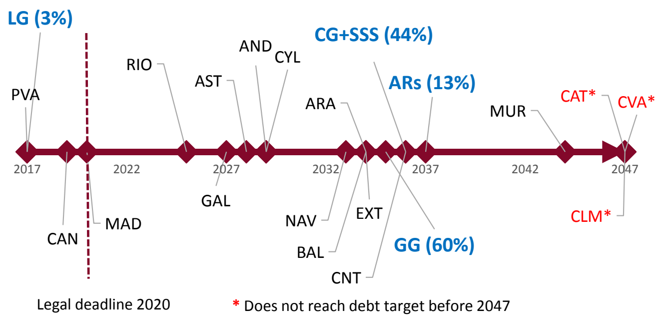
Source: INE, IGAE, Bank of Spain and AIReF estimates.

DEBT SUSTAINABILITY RISK INDICATOR



- In 2017, on average, a person in Spain would need to allocate 89 working days to amortize 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.
- The weight of extraordinary financing mechanisms on the ARs has been increasing both in absolute terms (□59,526 million) and in relative terms, representing 56.1% of the regional sub-sector□total debt. In MUR, CVA, AND, CNT, BAL, CAT and CLM, the State financing mechanisms account for close to or even over 70% of the regional debt.
- The risks to financial sustainability in the medium term for the ARs are high, although they have decreased slightly throughout 2017. The ARs present a mixed picture, with CAT, CLM, MYR and CVA standing out with a very high risk. EXT and AND are situated two levels down and in third place ARA and BAL present a medium risk level. CAN and CYL have a moderately low risk level, as is the case for AST and GAL. Finally, NAV and RIO present low sustainability risks, along with CAN, MAD and PVA.
- It is estimated that the AR sub-sector will not reach a debt level below 13% of GDP before 2037 in the baseline scenario. As well as the Local Government subsector, which already reached the reference level in 2016, it is projected that only PVA, CAN and MAD will reach the reference level before 2020.

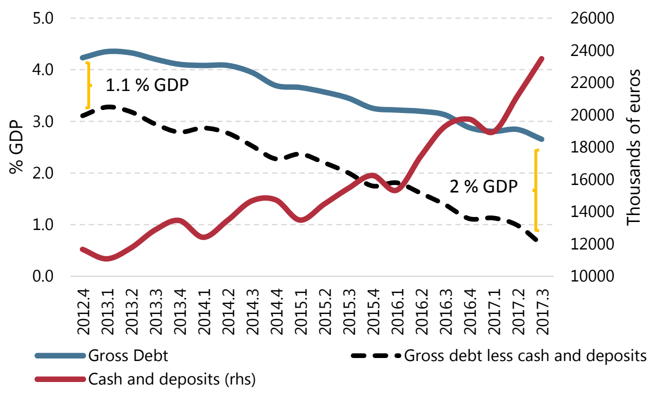
DEBT-TO-GDP REFERENCE LEVEL ESTIMATED ACHIEVEMENT YEAR



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

GRAPH 10. DEBT DETERMINANTS OF THE LOCAL GOVERNMENTS SUB-SECTOR

EVOLUTION OF THE DEBT RATIO AND DEPOSITS



- After declining below 3% of 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 important primary balances recorded by the sub-sector are being used to increase bank deposits.
- Since the end of 2012, LG deposits have almost doubled in terms of GDP (2%), exceeding □23 million. Accordingly, the debt net of liquid financial assets dropped to 0.6% of 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.