Rating Update

Creditreform Rating affirms the credit ratings of the Kingdom of Spain at “A-”, outlook “negative”

Rating Action

Neuss, 16 July 2021

Creditreform Rating has affirmed the unsolicited long-term sovereign rating of “A-” for the Kingdom of Spain. Creditreform Rating has also affirmed Spain’s unsolicited ratings for foreign and local currency senior unsecured long-term debt of “A-”. The outlook is negative.

Reasons for the Rating Decision and Latest Developments[1]

Macroeconomic Performance

Spain’s favorable macroeconomic performance profile is buttressed by its very large, competitive, and wealthy economy. A rebound from the Covid-19-shock is underway amid well-progressing vaccinations, and could precede a phase of comparatively strong growth as seen in the years prior to the corona pandemic if the sizeable funds via NextGenerationEU (NGEU) are effectively implemented along the lines presented in the Recovery, Transformation and Resilience Plan (RTRP). The plan also addresses structural challenges regarding the Spanish labor market, which along with the comparatively high unemployment rate weigh on our credit assessment as they dampen Spain’s medium-term growth outlook. Concern over possible scarring effects from the pandemic persists, not least given the uncertainty regarding more contagious virus strains and a possibly insufficient level of immunity, all of which has the potential to slow down the recovery in the country’s important tourism sector.

Following average real GDP growth of 2.6% in 2014-19 (euro area (EA): 1.9%), Spain was strongly affected by the outbreak of the Covid-19 pandemic, compounded by its negative reverberations for tourism and, to some extent, by the strong presence of micro-enterprises. The latter account for a higher share of value added (21.9%, OECD: 17.4%) and employment (36.3%, OECD: 28.9%) than the OECD average and, depending on the industry, tended to be hit harder in this crisis. Real GDP ultimately plunged by 10.8% last year, representing the steepest decline among the euro area members (EA: -6.5%), with swift and substantial fiscal support measures preventing an even worse outcome. According to IMF estimates, GDP per capita thus shrank by 9.9% to USD 38,392 (PPP terms, current prices) last year, broadly in line with the median of our A-rated sovereigns.

As was the case in most European countries, private consumption saw the strongest contraction (-7.0%), stifled by strict containment measures in view of several infection waves. With tourist activity virtually at a standstill for parts of the year, and against the backdrop of disruptions to trade, exports slumped by 20.2%. Net exports ultimately contributed a negative 2.1 p.p. to the

[1] This rating update takes into account information available until 12 July 2021.

overall growth outcome. Gross fixed capital formation, meanwhile, fell by a comparatively moderate 2.2%.

As autumn and winter 2020/21 were burdened by a second and third infection wave, requiring renewed social distancing, and in the face of severe winter weather constraining construction activity, the Spanish economy was more or less in a recession in Q4-20 and Q1-21, leaving real GDP still 9.3% (Eurostat, 2015 prices, sa, cadj) below its pre-crisis level (Q4-19) in Q1-21 (EA: -5.1%). Rising demand for intermediate products amid vivid economic recovery in countries such as China and the US, along with the temporary blockage of the Suez Canal, contributed to some supply shortages, also weighing on Spain's economic activity.

However, amid progressing inoculation, with regard to which Spain seems well ahead of the EU as a whole (ECDC data), and a gradual lifting of containment measures, the Spanish economy is likely to have rebounded markedly in Q2-21. Judging by available data, real GDP may have expanded by about 2% q-o-q in the second quarter. The Purchasing Manager Indices for the service and the manufacturing sectors rose strongly in May and June respectively, moving well into expansionary territory and hinting at accelerated growth, while increases in new export orders point to more vivid export activity. Even though the introduction of the digital EU vaccination certificate in July should facilitate travelling for those who have been immunized or who have recovered from Covid-19, tourism looks set to remain restrained, not least in light of considerable uncertainty over possible restrictions owing to the more contagious delta variant of coronavirus, and to the further evolution of the virus.

Looking ahead, our main scenario remains that Spain's economic recovery will firm on the back of accelerating domestic demand, but also supported by a more advanced level of immunization and recovery in important trading partners, among them the US and the UK. Domestic demand should take the lead this year, with private consumption bouncing back as containment measures are gradually eased, and bolstered by the purchasing power of households, which was broadly maintained, as many jobs have been retained thanks to the ERTE schemes which have been extended until the end of September.

Against the backdrop of the recently brightening economic picture, the number of workers under short-time work schemes was down to roughly 447.8 thousand as of Jun-21 according to provisionary figures, compared to a peak of about 3.576mn in Apr-20 and an increase to approx. 928 thousand in Jan-21 (Ministry of Inclusion, Social Security and Migration). Monthly unemployment dropped to a still high 15.3% in May-21 (EA: 7.9%, LSF-adj.) from a peak of 16.5% in Aug-20. The improving economic situation is also reflected in monthly data regarding effective social security registrations (excl. furloughed employees), which have been increasing since March, standing 4.4% below their pre-crisis level in May-21. As a further supportive factor, the Minimum Vital Income, introduced last year to complement minimum income and help prevent severe poverty, has an envelope of EUR 3bn and will remain in force throughout 2021.

We expect gross fixed capital formation to be backed by resuming global demand and ongoing favorable financial market conditions, as well as by the deployment of Recovery and Resilience Facility (RRF) funds to enhance existing or create new digital and green infrastructure. Apart from that, we also expect residential investment to add positively to growth, not least with a view to further RRF funds dedicated to increasing energy efficiency of housing. Industrial production rose for a third consecutive month in May, posting an increase of 5.3% vs. Dec-20.

Turning to external trade, tourism remains dragged down by the health situation, as reflected in a decline by 71.5% of total expenditure by international tourists in the first five months of the year compared to the same period last year. Total service exports in Q1-21 were less than half of what they were shortly before the outbreak of corona (Q1-21 vs. Q4-19: -53.3%). Goods exports, on the other hand, have nearly recouped all lost ground, posting only 1.4% below their Q4-19 level.

Given the significance of its tourism sector, which accounts for 12.3% of GDP (2018, OECD data), Covid-19 thus weighed heavily on Spain's global market share in terms of service exports last year (2020: 1.85%, 2019: 2.60%), whereas its share in global goods exports was broadly stable (2020: 1.76%, 2019: 1.77%). Notwithstanding persisting supply shortages for certain products, such as semi-conductors, the positive economic prospects in important export markets should continue to provide growth impulses for the remainder of the year and beyond. We anticipate net trade to make a moderately positive contribution to GDP growth in 2021 and 2022, with the contribution next year likely somewhat higher, as tourism should become livelier.

Overall, we now expect real GDP to grow by 6.0% in 2021, followed by further expansion to the tune of 6.2% in 2022. A reported high inclination of the population to get vaccinated, according to surveys, arguably improves prospects of a more stable recovery, with the caveat of possibly declining effectiveness of available vaccines as virus mutations possibly continue. The latter remains a palpable risk.

Despite lingering uncertainty associated with the coronavirus, prospects pertaining to the medium-term growth outlook may have improved, insofar as the European Commission has endorsed Spain's national recovery and resilience plan foreseeing substantial and front-loaded investment to foster the digital transition and greening of the economy, thus clearing the way for full concentration on its implementation. Envisaged measures would also partly address deficiencies weighing on the Spanish labor market, such as segmentation (permanent vs. temporary employment), regional disparities, and the need for upskilling segments of the workforce to enhance productivity and competitiveness. Roughly two-thirds of the allocated total of EUR 69.5bn in terms of grants, which represents the largest volume among the EU members, could be deployed by the end of 2022, with a larger growth effect likely to take place next year if reforms are implemented rapidly and effectively. According to the Spanish authorities, a full implementation of the RTRP measures would lift GDP in aggregate by 2 p.p. per year and create more than 800,000 jobs over the next three years.

Still, a number of key reforms have yet to be fleshed out in more detail (see below). The delay of the tax review, as recently announced by the Prime Minister, may be a case in point for some concern over timely and targeted reform implementation. Having said this, we acknowledge the considerable challenge of having to balance stabilization of the recovery in the short term and embarking on structural reforms that will benefit the economy in the more medium term.

Private sector debt ratios have gone up during this crisis, although to a certain extent driven by falling GDP, with NFC debt-to-GDP rising significantly by 12.4 p.p. to 85.2% in the year to Q4-20, moving in the upper middle-range among the euro area countries. Household debt increased more moderately, by 2.1 p.p. to 94.8% of disposable income over the same period, also occupying middle ground compared to other euro area members. Lending to NFCs increased vividly in the most acute phase of the crisis, but has been calming more recently, with outstanding loans declining by 2.2% y-o-y in May-21. An overhaul of the insolvency framework with the aim of facilitating preventive debt restructuring and improving on further tools could help to smooth

the transition from the expiring bankruptcy moratorium foreseen for the end of the year, given envisaged implementation of the reform by the end of 2021.

Institutional Structure

We continue to view Spain's strong institutional framework, which is also broadly confirmed by the World Bank's Worldwide Governance Indicators on par with the respective values of our 'A' rated sovereigns, as a major pillar underpinning the sovereign's credit rating. This includes significant advantages stemming from EU/EMU membership, as currently also demonstrated by substantial support through NGEU. The latter should enable reinvigorated reform momentum, albeit against the backdrop of a fragmented political landscape including a minority government. The regional election held in Catalonia is a recent case in point when it comes to fragmentation, as it yielded a narrow majority to parties in favor of independence.

The Catalonian regional election from February this year, in our view, has not made cohesive policy-making easier. Rather, in the current political context it will remain challenging, in particular against the backdrop of having to stabilize recovery and steer the economy towards a more digital and environmentally more sustainable growth path. That said, we understand that the central government will engage in talks with the newly-elected Catalonian leadership in September, following efforts to reduce tensions over secessionist movements by pardoning imprisoned Catalan separatists.

Picking up on possibly reinvigorated reform momentum, the bill on measures to prevent tax fraud was finally approved by Congress in June 2021, among other things encompassing limits on cash payments, expressly prohibiting tax amnesty in Spain, and information requirements on holdings and trading of cryptocurrencies. The government's July approval of urgent measures to reduce temporary employment may hint at reform implementation gaining some traction as well.

An agreement reached between the government and the social partners over the first phase of the envisaged pension reform in June 2021 - including relinking pensions to consumer price inflation (CPI) and involving incentives for longer lasting professional careers - also suggests that reaching consensus remains feasible. We will continue to closely monitor developments on this, also from a fiscal sustainability perspective (see below). Moreover, emphasizing the focus on maintaining the recovery momentum and implementing RTRP, Prime Minister Sanchez also reshuffled his cabinet in July.

While we have more visibility on foreseen investment under the RTRP, labor market reforms, as well the now pushed-back taxation reform, require greater detail, also in terms of timing. Under the impression of a somewhat slow absorption of the 2014-2020 ESIF funds, we would still flag some caution as to expectations of swift implementation. This being said, we are aware of a new law introduced in December 2020 that aims to facilitate public procurement and budgetary procedures by simplifying regulations, suggesting that deficiencies in this area are being addressed. Moreover, the RTRP envisages establishing strong governance and participation around the goals and progress made towards them, with social dialogue, a high degree of coordination, as well as control and audit along the way as important steps/levers.

Aside from the measures touched upon in the RTRP, we think the abovementioned overhaul of the insolvency law might assist in tackling the issue of enhancing the efficiency of Spain's judicial

system. As highlighted by the recently updated EU Justice Scoreboard, the time needed to resolve litigious civil and commercial cases remains relatively long, although there was some improvement compared to the preceding year. Further on the subject of judicial developments, we gather that Parliament has passed a controversial reform which foresees banning the reappointment of judges whose term has expired by the General Council of the Judiciary (CGPJ).

In terms of greening the economy, Spain is committed to reducing GHG emissions by 26% by 2030 (compared to 2005) with regard to non-ETS emissions (i.e. outside of the EU emissions trading system) for sectors such as transport, waste, and agriculture. The overall aim of full decarbonization by 2050 remains in place, as also confirmed by the Climate Change and Energy Transition Act approved by Parliament this May. The new law also bans the sale of CO2-emitting vehicles by 2040. Further initiatives to foster greening the economy include the National Energy and Climate Plan (NECPs) 2021-2030 and the Strategy on Fair Transition. Compared to the EU overall, Spain emits less GHG per capita, 7.1 tons vs 8.4 tons p.c. in 2019. Looking at the European Commission's Eco-Innovation Index, Spain occupies a decent 11th position among the EU member states plus UK (2019). Latest available data also show that the overall share of renewable energy has increased to 18.4% in 2019 (2014: 16.2%), moving slightly below the EU average (2019: 19.7%).

Fiscal Sustainability

Having to combat the pandemic and cushion the fallout from necessary protective measures caused the general government deficit to soar, and pushed the public debt ratio to new heights from an already elevated level. This has aggravated the sovereign's key credit weakness, from our point of view. Despite significant progress regarding vaccinations, uncertainty over new virus strains and their significance for the effectiveness of available vaccines remains pronounced. While there is strong commitment to build on spending reviews, and although we expect the public debt ratio to embark on a downward trajectory in the medium term, uncertainty over the pace and scope remains high, notwithstanding substantial financial support through NGEU. We acknowledge that the quality of debt is given a higher priority in this exceptional phase. Relinking pensions to CPI is, in our view, likely to raise fiscal pressure in the longer term, although the overall design of the pension reform is pending. Risks via the banking sector seem by and large contained at this stage, but will have to be monitored. Ultimately, we continue to see risks to fiscal sustainability as mitigated by sound debt management, which has led to an improved debt profile and increasing debt affordability, aided by the ECB's monetary policy.

Spain's general government deficit ultimately came in at 11.0% of GDP for 2020, markedly higher than that of the euro area overall (-7.2% of GDP), but also incorporating a one-off effect of 0.9 p.p. due to the reclassification of SAREB into the general government sector. In addition to the steep decline in GDP, the deficit was mainly driven by support aimed at the health sector, protecting the vulnerable and cushioning employment and respective incomes, whilst ensuring that enterprises were in a position to continue operating.

In light of the Covid-19 crisis, total government expenditure rose by 12.0% y-o-y last year, largely driven by social benefits (+15.9%), but also by a rising public wage bill (4.5%). The expenditure-to-GDP ratio leapt from 42.1% of GDP to 52.3% in 2020. Meanwhile, total government revenue dropped by 5.0% in 2020, mainly under the impression of a broad-based contraction in tax revenue (-7.8%). Given the strong contraction in GDP, the revenue-to-GDP ratio rose from 39.2% to 41.3% of GDP in 2020 (EA: 46.8% of GDP).

As of June 2021, direct budgetary support since the outbreak of the pandemic amounted to about 6.3% of GDP. Combined with comprehensive liquidity measures, the support package came to roughly 20.6% of GDP (Tesoro data). Amid a third wave of infections, the government adopted new measures this March, amounting to EUR 11bn, mainly in the form of support to (viable) companies particularly affected by the pandemic, including EUR 7bn in the form of grants. Moreover, the furlough schemes were extended until end of Sep-21, and in June the government approved a temporary reduction of the price of electricity until the end of the year.

The measures will thus at least partially offset the effect on the general government balance of revenue-raising tax measures, as announced with the Budget 2021 and in force since the beginning of this year. In this regard, key measures are a higher tax rate for high-income earners, a wealth tax, a financial transaction tax on the purchase of shares of Spanish companies, and a digital services tax. The Budget 2021 also included the use of EUR 26.6bn of the NGEU funds, half of which are dedicated to public investment. As of May-21, the general government deficit stood at 2.5% of GDP in cash terms, in the face of a surge in revenue by 11.1% in the first five months of 2021 as compared to the same period one year prior, driven by climbing tax income. Expenditure increased by a more moderate 5.1% over the same period, mirroring the positive effects of easing restrictions on economic activity and public finances.

With uncertainty over any headline deficit forecast remaining high in the face of possible further extension or re-introduction of some support amid unclear epidemiological developments, we tentatively pencil in a general government deficit of 8.5% of GDP for 2021. In the coming year, ongoing strong GDP growth and phased-out support measures should result in a markedly smaller negative headline balance, which we estimate to be around 5.0% of GDP.

Given the strongly contracting economic output and soaring deficit, Spain's debt-to-GDP ratio swelled from an already elevated 95.5% to 120.0% last year, and further to 123.6% in Apr-21. Against the backdrop of expected strong GDP growth this year and a declining deficit, we anticipate the public debt ratio to stabilize at about 120.3% of GDP in 2021, before dropping more markedly to roughly 117.3% of GDP in 2022.

With regard to the medium term, the government expects the negative headline balance to shrink to 3.2% by 2024 (SP21), although we note that the measures to strengthen public finances appear rather indicative and seem to lack deeper specification. The debt-to-GDP ratio is expected to fall to 112.1% in 2024. We would stress that the delay of a structural tax review adds to our concern over the envisaged consolidation of public finances, while acknowledging that it is vital not to compromise the economic recovery at this stage. Moreover, we would echo some concerns expressed by AIReF over a current lack of sufficient detail on the macroeconomic and fiscal effects of investments and reforms under the RTRP.

Turning to contingent liabilities, the banking sector has been relatively resilient so far, entering the pandemic from a much stronger position than at the time of the global financial crisis - after years of deleveraging, with more solid capital buffers and significantly improved asset quality - although the picture may be distorted somewhat by loan moratoria that had been extended until Mar-21. However, as suggested by a diminishing return on assets (RoA) between Q2-20 and Q4-20, loan loss provisions have taken their toll on banks' profitability, in addition to the ongoing low interest-rate environment. Having said this, RoA improved in Q1-21 (1.0%, EBA). The NPL ratio stood at 3.1% in Q1-21, broadly stable compared to Q4-19 (3.2%, EBA).

To this end, we observe that the share of stage 2 loans has edged up to 7.1% of total loans, advancing in Q4-20, while remaining below the EU average (Q4-20: 9.1%, EBA). However, the share of stage 2 loans and advances with non-expired EBA-compliant moratoria has increased by 10.0 p.p. to 26.0% from Q2-20 to Q4-20. We would thus continue to monitor asset quality vigilantly going forward, also bearing in mind a potentially less benign situation as regards solvency of enterprises and the labor market as support measures are withdrawn. What is more, exposure of some banks to emerging markets through subsidiaries in economies severely affected by the pandemic, or vulnerable for reasons beyond that (Brazil, Mexico, Turkey), may add to risks in some cases.

As touched upon further above, a notable share of the increase in the public debt ratio was explained by SAREB's reclassification. Although we do not see any acute risks of a resurfacing sovereign-bank nexus, the reclassification may serve as a reminder that these kind of risks should not be entirely dismissed. The share of government bonds held by Spanish banks has diminished over the years, but remains somewhat elevated at 7.7% of banks' total assets (ECB data, May-21).

Adding to contingent liability risks, public guarantees over EUR 97.1bn (of a EUR 140bn envelope), corresponding to 8.7% of 2020 GDP and thus suggesting a very strong take-up, have been provided to the private sector. Emphasizing the significance of micro-SMEs for the economy, approx. 74% of this was handed out to micro-SMEs and self-employed. With the abovementioned March package, two additional funds were provided, with EUR 3bn for possible loan restructurings guaranteed by ICO, and EUR 1bn for recapitalizations managed by COFIDES.

According to the most recent EU Aging Report (2021) age-related costs remain by and large moderate by European comparison, projected to rise by 0.3 p.p. to 22.6% of GDP by 2030 and even to decline to 21.9% of GDP by 2070. However, the pension reform may lead to increasing pressure, but will have to be monitored, as its full design is yet to be decided.

We remain of the view that risks to fiscal sustainability continue to be largely mitigated by a favorable debt profile, thanks to persistently sound debt management and to improved debt affordability, as manifested in another strong fall in interest expenditure (-11.1%) to 5.4% of total revenue in 2020, or 2.3% of GDP (2019: 5.8% and 2.3%, respectively). The average weighted maturity of the sovereign's debt portfolio rose to 7.55y to 7.75y in 2019-20, and further to 8.1% in Jul-21 (Tesoro). Meanwhile, cost at issuance has continue to decline and went into negative territory for the first time this year (Jul-21: -0.02%). Drawing on IMF data on sovereign debt holdings, the share of general government debt held by Banco de Espana and the foreign official sector climbed to 34% in Q4-20 (Q4-19: 31%), further alleviating sustainability risks. Moreover, Spain is a large beneficiary of SURE, having been disbursed EUR 21.324bn in loan support for its labor market.

Despite an increase in the yield on 10-y government bonds by about 25bp to 0.38% (week of 2 July) since our last review, refinancing conditions remain very benign and close to historical lows. We expect financial market conditions to remain favorable for the foreseeable future, given that the ECB at its June meeting confirmed net asset purchases under the Pandemic Emergency Purchase Program (PEPP) of EUR 1,850bn until at least the end of March 2022. Furthermore, the ECB continues its net purchases under the Asset Purchase Program (APP) at a monthly pace of EUR 20bn for as long as deemed necessary. As of June-21, the Eurosystem's cumulative asset purchases under the PSPP and the PEPP have totaled EUR 301.8bn and 122.6bn respectively, corresponding to 30.7% of total outstanding debt securities as of 2020 (Eurostat data).

Foreign Exposure

As far as Spain's external position is concerned, the Covid-19 pandemic has emphasized existing vulnerabilities as expressed in a large negative net international investment position (NIIP). The improving trend in the NIIP, excluding non-defaultable investment (NENDI), was also interrupted last year. However, risks remain somewhat mitigated by the sectoral composition of external debt, given that a relatively large part of this is held by the official sector. A prospective return to a more pronounced current account surplus once tourism normalizes should contribute to mitigating risks further.

Having contributed to lowering the large negative NIIP over a considerable period, Spain's current account surplus diminished by 1.4 p.p. to 0.7% of GDP in 2020 (5-year average 2015-2019: 2.4% of GDP), mainly on account of the shrinking services surplus (-2.8 p.p. to 2.3% of GDP) amid collapsing tourism. At the same time, the deficit in goods trade was reduced from 2.1% of GDP to 0.8% in 2020, supported by lower energy imports also due to lower oil prices, thus partly offsetting the effects stemming from changes in the service balance.

In the first quarter of the current year, the current account surplus (four-quarter moving sum) remained broadly stable at 0.6% of GDP, with a further diminished surplus in service trade nearly offset by a narrower goods deficit. Overall, we expect the current account surplus to widen slightly this year, as tourism and closely-linked services will remained hampered, while net exports (of goods and services) should turn moderately positive.

A return to a more pronounced current account surplus will not likely occur before tourism activity can recover to levels seen before the coronavirus struck, which we do not expect to happen before 2022, given current epidemiological developments. If implemented effectively, planned investments as regards the labor force, R&D, and green energy, as set out in the RTRP, could help to enhance the economy's competitiveness and reduce energy imports, thus prospectively firming the current account surplus on a higher level.

We thus expect the negative NIIP to resume its improvement as witnessed before the outbreak of coronavirus. In 2020, the negative position widened to -84.5% of GDP (2019: -73.9%), amid an increasing negative balance of the 'other investment' component and a more negative direct investment balance, partly influenced by valuation effects. Available data for the first quarter of the current year suggest the NIIP is stabilizing (Q1-21: -84.1% of GDP).

Rating Outlook and Sensitivity

Our rating outlook on the Kingdom of Spain's long-term sovereign ratings is negative, as we perceive risks to fiscal sustainability as outweighing institutional strengths and improving macroeconomic perspectives in an epidemiological context that still carries a high degree of uncertainty. Long-standing weaknesses have been exacerbated in the wake of the pandemic, with visible improvements having come to the halt, inter alia regarding private and public debt, unemployment, the external position, and asset quality in the banking sector. We continue to emphasize that the assessment and interpretation of economic developments remains more challenging than under normal circumstances, as is the case for other indicators, in particular from the fiscal realm.

We could consider downgrading Spain's credit ratings if our expectations as to its economic recovery are disappointed, resulting in a weakening medium-term growth outlook that might also come on the back of a delayed implementation of the RTRP. Downside risks would in particular

relate to further deteriorating public finances, which might be aggravated by possibly resurfacing risks in the banking sector via weakening asset quality and materializing contingent liability risks.

By contrast, a positive rating action could be triggered, if the public debt ratio follows a sustainable downward path along expectations expressed in the medium-term strategy which we consider feasible at this stage. This could be the case if economic growth evolves in line with, or exceeds, our expectations, buttressed by timely and decisive implementation of announced investment and reform measures that would also enhance prospects for potential growth. A swift recovery in tourism would be conducive to such a scenario.

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Ratings*

Long-term sovereign rating	A- /negative
Foreign currency senior unsecured long-term debt	A- /negative
Local currency senior unsecured long-term debt	A- /negative

*) Unsolicited

Economic Data

[in %, otherwise noted]	2015	2016	2017	2018	2019	2020	2021e
Macroeconomic Performance							
Real GDP growth	3.8	3.0	3.0	2.4	2.0	-10.8	6.0
GDP per capita (PPP, USD)	34,939	37,310	39,626	41,389	42,609	38,392	41,546
Credit to the private sector/GDP	138.0	129.1	120.6	111.2	105.6	121.7	n/a
Unemployment rate	22.1	19.6	17.2	15.3	14.1	15.5	n/a
Real unit labor costs (index 2015=100)	100.0	98.9	98.2	98.1	99.1	103.1	n/a
Ease of doing business (score)	75.9	77.6	77.6	77.7	77.9	n/a	n/a
Life expectancy at birth (years)	83.0	83.5	83.4	83.5	84.0	82.4	n/a
Institutional Structure							
WGI Rule of Law (score)	0.9	1.0	1.0	1.0	1.0	n/a	n/a
WGI Control of Corruption (score)	0.6	0.5	0.5	0.6	0.6	n/a	n/a
WGI Voice and Accountability (score)	1.0	1.0	1.0	1.1	1.1	n/a	n/a
WGI Government Effectiveness (score)	1.2	1.1	1.0	1.0	1.0	n/a	n/a
HICP inflation rate, y-o-y change	-0.6	-0.3	2.0	1.7	0.8	-0.3	2.0
GHG emissions (tons of CO2 equivalent p.c.)	7.6	7.4	7.6	7.5	7.1	n/a	n/a
Default history (years since default)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Fiscal Sustainability							
Fiscal balance/GDP	-5.2	-4.3	-3.0	-2.5	-2.9	-11.0	-8.5
General government gross debt/GDP	99.3	99.2	98.6	97.4	95.5	120.0	120.3
Interest/revenue	7.8	7.2	6.6	6.2	5.8	5.4	n/a
Debt/revenue	256.5	260.0	258.2	248.7	243.7	290.4	n/a
Weighted average maturity of debt (years)	6.2	6.5	6.9	7.4	7.5	7.8	n/a
Foreign exposure							
Current account balance/GDP	2.0	3.2	2.8	1.9	2.1	0.7	n/a
International reserves/imports	0.2	0.2	0.2	0.2	0.2	0.3	n/a
NIIP/GDP	-88.9	-85.5	-84.9	-79.2	-73.9	-84.5	n/a
External debt/GDP	168.9	168.7	167.9	167.7	169.6	199.4	n/a

Source: IMF, World Bank, Eurostat, AMECO, ECB, INE, own estimates

ESG Factors

While there is no universal and commonly agreed typology or definition of environment, social, and governance (ESG) criteria, Creditreform Rating views ESG factors as an essential yardstick for assessing the sustainability of a state. Creditreform Rating thus takes account of ESG factors in its decision-making process before arriving at a sovereign credit rating. In the following, we explain how and to what degree any of the key drivers behind the credit rating or the related outlook is associated with what we understand to be an ESG factor, and outline why these ESG factors were material to the credit rating or rating outlook.

For further information on the conceptual approach pertaining to ESG factors in public finance and the relevance of ESG factors to sovereign credit ratings and to Creditreform Rating credit ratings more generally, we refer to the basic documentation, which lays down key principles of the impact of ESG factors on credit ratings.

The governance dimension plays a pivotal role in forming our opinion on the creditworthiness of the sovereign. As the World Bank's Worldwide Governance Indicators Rule of Law, Government Effectiveness, Voice and Accountability, and Control of corruption have a material impact on Creditreform Rating's assessment of the sovereign's institutional set-up, which we regard as a key rating driver, we consider the ESG factors 'Judicial System and Property Rights', 'Quality of

Public Services and Policies', 'Civil Liberties and Political Participation', and 'Integrity of Public Officials' as highly significant to the credit rating.

The social dimension plays an important role in forming our opinion on the creditworthiness of the sovereign. Labor market metrics constitute crucial goalposts in Creditreform Rating's considerations on macroeconomic performance of the sovereign, and we regard the ESG factor 'Labor' as significant to the credit rating or adjustments thereof.

While Covid-19 may have significant adverse effects on several components in our ESG factor framework in the medium to long term, it has not been visible in the relevant metrics we consider in the context of ESG factors – though it has a significant bearing concerning economic prospects and public finances. To be sure, we will follow ESG dynamics closely in this regard.

ESG Factor Box

Environmental Quality	Ecological Risks	Ressource Management	Education	Health	Demographics
Labor	Equality	Technology & Infrastructure	Safety & Security	**Judicial system**	**Quality of Public Services**
Integrity of Public Officials	Quality and Efficacy of Regulations	**Civil Liberties/ Political Participation**	Market Access	Business Environment	Data Transparency

Environment	Social	Governance	Highly significant	Significant	Less significant	Hardly significant

Appendix

Rating History

Event	Publication Date	Rating /Outlook
Initial Rating	30.09.2016	BBB+ /stable
Monitoring	01.09.2017	BBB+ /positive
Monitoring	27.07.2018	A- /stable
Monitoring	26.07.2019	A- /stable
Monitoring	24.07.2020	A- /negative
Monitoring	22.01.2021	A- /negative
Monitoring	16.07.2021	A- /negative

Regulatory Requirements

In 2011 Creditreform Rating AG (CRAG) was registered within the European Union according to EU Regulation 1060/2009 (CRA-Regulation). Based on the registration Creditreform Rating AG is allowed to issue credit ratings within the EU and is bound to comply with the provisions of the

CRA-Regulation. The rating was not endorsed by Creditreform Rating AG from a third country as defined in Article 4 (3) of the CRA-Regulation.

This sovereign rating is an unsolicited credit rating. The Spanish Treasury participated in the credit rating process as it provided additional information and commented on a draft version of the rating report. Thus, this report represents an updated version, which was augmented in response to the factual remarks of the Spanish Treasury during their review. However, the rating outcome as well as the related outlook remained unchanged.

Unsolicited Credit Rating	
With Rated Entity or Related Third Party Participation	YES
With Access to Internal Documents	NO
With Access to Management	NO

The rating was conducted on the basis of CRAG's "Sovereign Ratings" methodology (v1.2, July 2016) in conjunction with its basic document "Rating Criteria and Definitions" (v1.3, January 2018). CRAG ensures that methodologies, models and key rating assumptions for determining sovereign credit ratings are properly maintained, up-to-date, and subject to a comprehensive review on a periodic basis. A complete description of CRAG´s rating methodologies and basic document "Rating Criteria and Definitions" is published on our website.

To prepare this credit rating, CRAG used the following substantially material sources: International Monetary Fund, World Bank, Organization for Economic Co-operation and Development, Eurostat, European Commission, European Banking Authority, European Central Bank, World Economic Forum, European Centre for Disease Prevention and Control, Blavatnik School of Government, Tesoro Publico de Espana, Banco de Espana, Instituto Nacional de Estadistica (INE), Autoridad Independiente de Responsabilidad Fiscal española (AIReF), Sociedad de Gestión de Activos procedentes de la Reestructuración Bancaria (SAREB), Ministerio de Inclusion, Seguridad Social y Migraciones, Ministerio de Asuntos Económicos.

A Rating Committee was called consisting of highly qualified analysts of CRAG. The quality and extent of information available on the rated entity was considered satisfactory. The analysts and committee members declared that the rules of the Code of Conduct were complied with. No conflicts of interest were identified during the rating process that might influence the analyses and judgements of the rating analysts involved or any other natural person whose services are placed at the disposal or under the control of Creditreform Rating AG and who are directly involved in credit rating activities or approving credit ratings and rating outlooks. The analysts presented the results of the quantitative and qualitative analyses and provided the Committee with a recommendation for the rating decision. After the discussion of the relevant quantitative and qualitative risk factors, the Rating Committee arrived at a unanimous rating decision. The weighting of all risk factors is described in CRAG´s "Sovereign Ratings" methodology. The main arguments that were raised in the discussion are summarized in the "Reasons for the Rating Decision".

As regards the rating outlook, the time horizon is provided during which a change in the credit rating is expected. This information is available within the credit rating report. There are no

other attributes and limitations of the credit rating or rating outlook other than displayed on the CRAG website. In case of providing ancillary services to the rated entity, CRAG will disclose all ancillary services in the credit rating report.

The date at which the credit rating was released for distribution for the first time and when it was last updated including any rating outlooks is indicated clearly and prominently in the rating report; the first release is indicated as "initial rating"; other updates are indicated as an "update", "upgrade or downgrade", "not rated", "affirmed", "selective default" or "default".

In accordance with Article 11 (2) EU-Regulation (EC) No 1060/2009 registered or certified credit rating agency shall make available in a central repository established by ESMA information on its historical performance data, including the ratings transition frequency, and information about credit ratings issued in the past and on their changes. Requested data are available on the ESMA website: https://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml.

An explanatory statement of the meaning of each rating category and the definition of default are available in the credit rating methodologies disclosed on the website.

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