



ISSUER RATING

Long-term Rating

Outlook: Observation

First rating date: 26/10/2018

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Executive Summary

We maintain our credit rating of A for the Kingdom of Spain and change our outlook from “stable” to “under observation” with negative implications due to the economic scenario presented for 2020, strongly conditioned by the economic effects of the health crisis that has forced a large part of the activity to halt and whose duration is directly linked to the success of developing a suitable vaccine against the COVID-19.

Even though we expect an important contraction of the economy for 2020 (-5.5%) given the tertiary prevalence of the economy and the importance of the tourism activity, we foresee a gradual recovery of the economic activity during the second half of the year, with a rebound in 2021, although all of this is highly conditioned by the final duration of the pandemic.

Our rating considers the positive starting point of the Spanish economy in order to face this uncertain scenario, with a household and corporate debt at lower levels than the ones presented during the previous economic crisis. A persistent current account surplus, a more dynamic labour market, a context favoured by the application of ultra-expansive monetary policy and low oil prices. Also, we expect that the measures approved by the Executive (equivalent to 20% of GDP) will serve to mitigate the worst consequences of the crisis, mainly to avoid a liquidity crisis.

However, the rating is constrained by the expected deterioration of the public financial accounts that already lacked fiscal room, with a deficit that is expected to double that recorded in 2019 and a public debt that again will exceed 100% of GDP.

Structural problems affecting the dualism of the labour market remain and will be reflected in the destruction of jobs, not only by ERTes (temporary lay-off schemes) but also by all those temporary jobs linked to tourism activities. Additionally, excessive dependence on external debt and the social aspects related to the high rate of dependence and population at risk of social exclusion are a source of concern.

Fundamentals

Strengths

- ▶ Sustained economic growth which, until the declaration of the state of alarm, had exceeded its European peers.
- ▶ Dynamic labour market, although the pace of job creation had shown signs of slowing down.
- ▶ Increase of the volume of exports and the decline in imports has sustained the current account surplus and reduced the external debt.
- ▶ A coalition Government that provides stability but will depend on government agreements with the remaining political parties in order to adopt the necessary measures.

Weaknesses

- ▶ Uncertain economic scenario that will lead to an important contraction during 2020 but with an expected rebound in 2021.
- ▶ Tourist sector, one of the main drivers of the economy, will be one of the most affected by the crisis having a direct negative impact in the labour market where a duality problem persists.
- ▶ The narrow fiscal room, which worsened in 2019, will further deteriorate the situation of public finances caused by the approved social containment measures and the ensuing economic shut-down.
- ▶ The national dependency on external debt increases its vulnerability to financial shocks.

Main Figures

	2017	2018	2019e	2020e
Real GDP (interannual change)	2.9%	2.4%	2.0%	-5.5%
GDP per capita (current, €)	25,100	25,900	26,700	-
HCPI (end of period)	1.2%	1.2%	0.8%	0.3%
Unemployment rate	17.1%	14.5%	13.7%	-
People-at-risk (% population)	26.6%	26.1%	-	-
Private debt (% GDP)	157%	153%	153%	-
Current Account Balance (% GDP)	1.8%	0.9%	1.9%	1.9%
NIIP (% GDP)	-86%	-80%	-77%	-
NPL	7.8%	5.8%	5.0%	-
Loan-to-deposits (OSR)	1,10	1,03	1,00	-
Fiscal Balance (% GDP)	-3.0%	-2.5%	-2.6%	-5.0%
Primary Balance (% GDP)	-0.5%	0.0%	-0.1%	-
Public Debt (% GDP)	98.6%	97.6%	97.%	103%

Sources: INE, BdE, Eurostat, Ministry of Finance, European Commission, IMF, OCDE and Axesor.

Outlook

We change the outlook of our rating from “stable” to “under observation” with negative implications given the uncertainty surrounding the current health crisis. Although we expect that the numerous stimulus measures approved by the government will have a positive effect in containing the most negative effects, especially in terms of a liquidity shock, many of these measures have yet to be implemented by the Executive in terms of social aid, support to affected sectors and the self-employed, among others.

In addition, the economic scenarios outlined for the coming years are drafted in a context of uncertainty, the main one being the duration that the pandemic will have in Spain, one of the most affected countries in the world. Therefore, it is foreseeable that its effects may even extend into the summer, which is particularly important for the Spanish economy because of its strong tourist sector.

Rating Committee

The Rating Committee has agreed to maintain the credit rating with a change in trend from stable to under observation given the current environment of uncertainty surrounding the 2020 economic outlook, highly dependent on the evolution of the health crisis. The effect of this shock on the labor market and public finances has also been analyzed.

Regulatory information

Sources of information

The credit rating issued in this report is unsolicited. The credit rating is based exclusively on public information, being the main sources the following:

1. Public information from public access sources, mainly official statistics institutes, central banks, and other government sources, in addition to the OECD, Eurostat, World Bank, European Central Bank and International Monetary Fund, among others.
2. Own information of Axesor Rating.

The information was thoroughly reviewed to ensure that it is valid and consistent, and is considered satisfactory. Nevertheless, Axesor Rating assumes no responsibility for the accuracy of the information and the conclusions drawn from it.

Level of the rated entity participation in the rating process

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

Additional information

- The rating was carried out in accordance with Regulation (EC) N°1060/2009 of the European Parliament and the Council of 16 September 2009, on credit rating agencies, and in accordance with the Sovereign Rating Methodology and Outlook Methodology that can be consulted on www.axesor-rating.com/en/about-axesor/methodology and according to the Long-term Sovereign Rating scale available at www.axesor-rating.com/en/about-axesor/rating-scale.
- Axesor publishes data on the historical default rates of the rating categories, which are located in the central statistics repository CEREP, of the European Securities and Markets Authority (ESMA).
- In accordance with Article 6 (2), in conjunction with Annex I, section B (4) of the Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009, it is reported that during the last 12 months axesor has provided ancillary services to related third parties of the rated entity, but not to the rated entity. However, according to our Conflict of Interest Policy, it does not involve a conflict of interest, since the aggregate sale does not exceed 5% of net turnover.
- The issued credit rating has been notified to the rated entity, and has not been modified since.

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