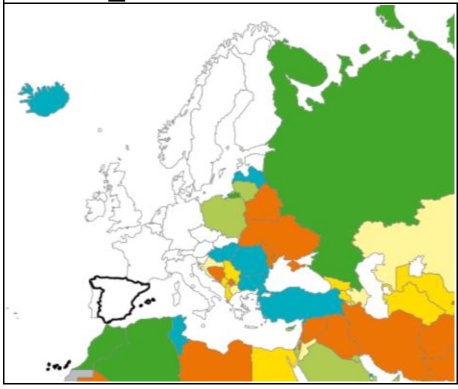
COUNTRY RISK ANALYSIS

Spain

CREATING
CONFIDENCE
IN YOUR EXPORTS



COUNTRY RISK CATEGORY

0/7

The country risk categories range from 0 to 7. The lower the number the better the credit rating the country has.

0 1 2 3 4 5 6 7

EKN'S OUTSTANDING GUARANTEES ON THE COUNTRY

SHORT-TERM TRANSACTIONS: -

MEDIUM AND LONG-TERM TRANSACTIONS:
SEK 12,419 MILLION

DATE

25/09/2014

Shaky recovery

Spain is one of the euro zone countries hardest-hit by the global financial crisis. As opposed to other euro zone countries that have gone through public finance crises, the public finances in Spain were relatively sound at the start of the financial crisis. Spain was also one of the fastest-growing countries in the euro area, mainly driven by a strong expansion in the construction sector. When the international economic climate took a downward turn in early 2008 and turbulence on the financial markets increased the housing and property market collapsed, which had major spill over effects on the real economy. The crisis in the construction sector led to major losses in the banking sector, which were alleviated by state capital injections, but led to a rapid deterioration of the public finances and a rise in the public debt to levels that created turbulence on the financial markets. After several years of fiscal austerity, extensive reconstruction of the banking sector and at least partially initiated structural reforms, the prospects for growth have improved and the stability of the financial system has strengthened. A broad coalition surrounding the economic policies on the central level has strongly contributed to the government succeeding in turning things around. However, an escalation in regional nationalism has created a political split and at times jeopardised the reform efforts. It is highly likely that the Spanish economy is on the right path. However, many imbalances remain and are in need of correction, so the path forward will be long and bumpy. The recovery in the construction sector will take some time and will have a less dominant role as a driver of economic growth in the future. Stronger competitiveness will instead create opportunities for the export oriented industrial sector to expand. As the recovery of the economic climate gets a stronger foothold and inflation increases, the prospects for continuing consolidation of the public finances are expected to improve.

THE COUNTRY'S STRENGTHS AND WEAKNESSES

Strengths

- Large and well-diversified economy with high GDP per capita.
- Politically stable and broad parliamentary support for economic policies.
- Stronger competeviness via a reduction in costs in the economy.

Weaknesses

- Mass unemployment, high private and public debt.
- A housing and property market that continues to be weak and a large stock of unsold residential properties.
- Weak banking sector as a result of the crisis on the housing and property market.

EKN'S POLICY

General risk assessment

Similarly to most euro zone countries and other high-income countries, EKN has placed Spain in country risk category 0. Spain's membership in the euro zone makes the transfer and conversion risk low. There are no other financial and economic circumstances that justify any restrictions on the country policy. Instead, each transaction is assessed on its own merits. In accordance with the EU's competition regulations, EKN and other export credit institutions may not cover any payment risks for transactions where the risk term is less than two years. Euro zone countries and other high-income countries in the OECD are not categorised within the scope of the OECD's country risk categorisation.

WHAT MIGHT CAUSE A CHANGE IN THE COUNTRY POLICY?

The policy may be made more restrictive

- If the on-going consolidation of the public finances and reform efforts stall and if the sustainability of the public finances is once again called into question by investors.
- Increased political and regional polarisation with demands from the most pro-independence regions to secede from Spain.
- If the problems in the banking sector return and the banks face financing problems.

EKN'S OBLIGATIONS AND EXPERIENCE

Increased exposure during the financial crisis

The inflow of new transactions to Spain increased substantially in conjunction with the financial crisis. As the financial situation in the country has gotten stronger, the provision of both offers and guarantees has waned. EKN's total exposure to Spain is just over SEK 15 billion, with outstanding guarantees accounting for around SEK 12.5 billion and outstanding offers accounting for the rest. A large portion of the guarantees involve operations located in Latin America. EKN has solid experience overall in guaranteeing transactions in Spain.

COUNTRY ANALYST

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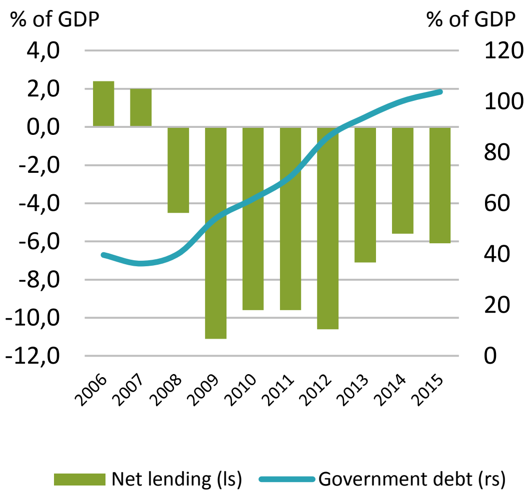
Deep recession followed by cautious recovery

Over the course of just a couple of years, Spain went from a fast-growing economy with low public debt to a country in a deep recession, with mass unemployment and major public finance problems. The crisis began in early 2008 and it would take six years before a recovery was in sight. The country's accession to the euro area brought down the economy's interest rates, which stimulated growth, but also led to rising private and public debt and the emergence of speculation and overinvestment. Strong expansion in the construction industry, stimulated by soaring housing and property prices, contributed to high growth and a rapid increase in employment. In conjunction with the global financial crisis the economic climate took a downward turn and the property and housing bubble burst. The crash in the construction sector had substantial spill-over effects in other parts of the economy and in the banking system. The slow-down in the labour-intensive construction industry led to rapidly rising unemployment, which brought down household purchasing power, and falling housing prices eroded household wealth. On the heels of the crash on the housing market, the banking sector found itself struggling, which placed a burden on the increasingly strained public finances of Spain. As the economic crisis got deeper, uncertainty on the financial markets increased and the interest rates for Spanish government bonds rose dramatically. Speculations about Spain potentially leaving the euro zone or the currency union being dissolved fanned additional flames on this uncertainty. Rising government debt costs forced the Spanish government to make increasingly far-reaching budget cuts, which further stymied demand in the economy, trapping Spain in a negative spiral. This pattern went on in several other euro zone countries with public finance problems, which resulted in suppressed demand in Spain's main trade partners also being stifled by heavy fiscal austerity. The government faced the difficult task of saving the financial system by pumping capital into the banking sector and simultaneously consolidating the public finances. To reduce the state's liquidity problems and mitigate the banking system's solvency problems, the Spanish government turned to the other euro zone countries for financial assistance in mid-2012. The Euro group agreed to issue a loan commitment for up to EUR 100 billion. This assistance loan for Spain was exclusively geared toward the banking sector and was conditioned upon Spain reforming its financial sector. As opposed to Ireland, Portugal and Greece, Spain thus avoided committing itself to a financial assistance programme with far-reaching terms and conditions surrounding the shaping of national fiscal policy. Spain exited its financial assistance programme in January 2014 and had used just over EUR 40 billion of the credit facility up to that point.

PUBLIC FINANCES

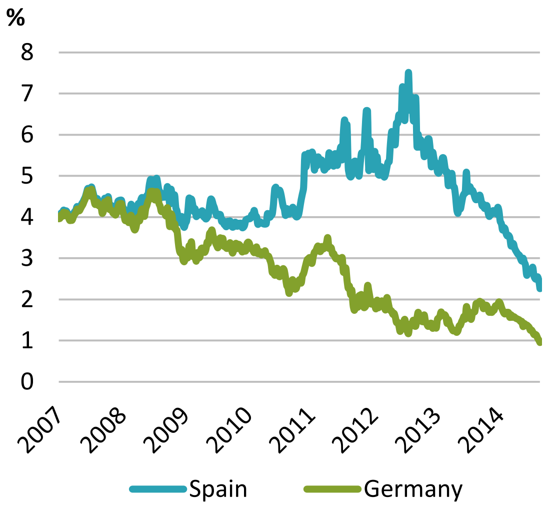


Source: European Commission (forecast years 2014-2015)

New shape of banking sector

At the start of the crisis, the banking sector in Spain consisted of several large global banks and many small regional savings banks. The biggest banks with branches in other parts of the world got through the crisis relatively well. The problem loans spread like wildfire in the first phase of the crisis in banks with high exposure to the domestic housing and property market, which were mainly small regional banks. Several banks had extremely urgent refinancing problems. The government was forced to take several measures to restore stability in the domestic financial system. Combined with state capital injections, these measures contributed to strengthening the stability of the banking sector. It will however take considerable time until the financial system reaches normalisation. The recovery on the housing and property market has begun, but it is estimated that it will take several years and a continuing price decline before the market has absorbed the stock of unsold residential properties accumulated during the crisis. Lending to the private sector is weak and the loan terms are tight, which particularly hampers small and medium sized companies. Overall, the situation of the Spanish economy has improved recently. The fiscal measures taken to strengthen the public finances, combined with the initiatives taken on the EU level to strengthen the stability of the financial system have contributed to the country regaining confidence on the financial markets. The improved financial position of Spain is reflected in part by an increase in its credit rating and a decrease in the interest rates for government securities. The deep and long economic slowdown has however led to an erosion of the economy's production capacity, with the economy expected to generate significantly lower GDP than the pre-crisis levels for several years to come.

GOVERNMENT BOND INTEREST RATES



Source: Reuters

Regional discontent over central power

There are historically strong tensions between Spain's regions and the central government in Madrid. The lack of budgetary discipline in the relatively autonomous regions during the crisis contributed to aggravating the market turbulence concerning the sustainability of Spain's public finances. To get more control over the finances of the regions, the government pushed through a change to the country's budget legislation which resulted in limitations on the autonomy of the regions. This triggered massive protests and the question of independence was given fresh fodder in several regions. Several economists are of the opinion that the autonomy of the regions led to ineffectiveness, bureaucracy and deficiencies in the legal system. Spain therefore needs to reform and modernise its constitution. As the economic recovery gets a stronger foothold and the fiscal policy is less aligned toward austerity, the demands of the regions for independence are expected to die down, but they will likely resurface again in the future.

BUSINESS ENVIRONMENT

From an international perspective, the business climate in Spain is relatively favourable. In relation to other OECD countries, the business environment has gotten worse in recent years. The government´s ambitions to increase tax revenues have led to a temporary increase in fees and taxes, which has reduced the predictability of the business environment. As the public finances have now strengthened, the government has announced measures to reduce corporate taxation, in a move to improve the business environment and promote investment and private entrepreneurship.