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LIST OF GRAPHS

ABBREVIATIONS

AENA	Aeropuertos y Navegación Aérea, Airports and Air Navigation
AIReF	Autoridad Independiente de Responsabilidad Fiscal, Independent authority for fiscal responsibility
ALMPs	Active Labour Market Policies
bps	basis points
CBE	Circular del Banco de España
CERSA	Compañía Española de Reafianzamiento, S.A., The Spanish Rebonding Company
CIT	Corporate Income Tax
CNMC	Comisión Nacional de Mercados y Competencia, National Commission for Markets and Competition
CRR	Capital Requirement Regulation
ESM	European Stability Mechanism
Euribor©	Euro Interbank Offered Rate
GDP	Gross Domestic Product
LFS	Labour Force Survey
LTD	Loans-to-Deposits
MARF	Mercado Alternativo de Renta Fija, Alternative Fixed-Income Market
MIP	Macroeconomic Imbalance Procedure
NFC	Non-Financial Corporation
NFCs	Non-Financial Corporations
NIIP	Net International Investment Position
NPL	Non-Performing Loan
PES	Public employment services
PIT	Personal Income Tax
PPS	Post Programme Surveillance
RDL	Real Decreto-ley, Royal Decree Law
SAFE	ECB Survey on the Access to Finance of small and medium-sized Enterprises
YG	Youth Guarantee

EXECUTIVE SUMMARY

This second post-programme surveillance report provides an assessment of Spain's economic, fiscal and financial situation following its exit from the financial assistance programme in January 2014. A staff team from the European Commission (EC), in liaison with staff from the European Central Bank (ECB) visited Spain in the context of the post-programme surveillance on 6-10 October.([1]) The report covers also the specific monitoring of policy progress by the Commission in the context of the Macroeconomic Imbalances Procedure.

Overall, recent economic and financial developments confirm the positive trends of stabilisation that have been unfolding over the last two years. These trends have been supported by a comprehensive reform agenda, successful financial sector restructuring and fiscal consolidation, as well as by favourable developments in global financial markets. Yet, it will be important to remain vigilant, as the large imbalances from the pre-crisis period and the related policy challenges in the labour market and beyond are still substantial and some important reforms are not yet completed. Achieving sustainable GDP and employment growth while completing the adjustment of imbalances and preserving social cohesion continue to pose a considerable policy challenge, requiring full and effective implementation of the reform agenda in line with the country specific recommendations (CSRs) adopted by the Council in July 2014. Commitment and joint delivery by all tiers of government remain essential to the success of many reforms and the correction of the high budget deficit.

The economic recovery has gathered momentum during 2014, with GDP expected to continue growing at a faster pace than the euro area average. The European Commission Autumn Forecast projects GDP growth of 1.2% in 2014 and 1.7% in 2015. Growth has been supported by a rise in domestic demand, while the external balance has weakened substantially as a result of a slowdown in export market growth and higher imports. Spain had a current account surplus in 2013 of 1.5% of GDP, the first in many years, but the surplus is likely to shrink in 2014. Domestic consumption and investment in equipment are underpinned by growing confidence, employment creation, recovered competitiveness, easing financing conditions, and low inflation. Unemployment is declining but the unemployment rate is still very high at nearly 24% and the labour market is characterised by a large stock of long-term unemployed, a high youth unemployment rate and significant segmentation between indefinite and temporary contracts. Inflation is below the euro area average and expected to stay low as a result of developments in commodity prices, remaining slack in the economy and further adjustment in relative price competitiveness.

Deleveraging is advancing but still high stocks of private and public debt and of external debt continue to pose risks to sustained growth and a challenge to the financial sector. The total stock of private sector debt in Q2 2014 was some 36.5% of GDP lower than the peak reached in 2010, but still amounted to 182% of GDP in non-consolidated terms. Public sector debt is still on an upward path, although the government expects it to peak in 2015 at slightly above 100% of GDP provided that the budget deficit targets for the coming years are met. The deterioration in net external demand limits the prospects of rapidly reducing the high negative net international investment position (-93% of GDP at the end of 2013). These large domestic and external debt levels imply further deleveraging needs in the various sectors of the economy.

While the 5.5% of GDP budget deficit target for 2014 appears within reach, fiscal consolidation needs in 2015 and 2016 remain substantial. Headline deficit reduction is being helped by the improving economy, including an underlying tax-rich growth structure. In spite of that, the Commission's 2014 Autumn Forecast points to a risk that the 2015 target might be missed. A full analysis of fiscal policy developments is outside the scope of this report, as the Commission will issue its assessment of euro area Member States' draft budgetary plans in November.

([1]) The European Stability Mechanism (ESM) participated in the meetings on aspects related to its own Early Warning System.

The Spanish financial sector has further stabilised over the past six months. Market indicators of systemic risk in the financial sector have continued to improve, reflecting positive trends in global financial markets, in the economy and in the sector itself. Financing costs of all sectors of the economy have further decreased and the availability of credit is gradually improving. However, notwithstanding this further stabilisation, also Spain did not escape some asset price volatility in the global mid-October market sell-off. This shows that the country remains vulnerable to sudden changes in global investor sentiment. Therefore, vigilance is required as well as the continuation of financial sector reform.

The performance and resilience of the banking sector have continued to strengthen. The liquidity situation of Spanish banks has improved further and solvency has been reinforced, supported by higher bank profits in the first half of 2014. The average quality of banks' assets has started to improve, as the ratio of non-performing loans has started to fall since December 2013. Private credit is still contracting, although at a decreasing pace. In some segments, notably lending to SMEs, new credit has actually started to grow. However, credit volumes are still shrinking across the main areas of business (though at a decreasing pace), putting a potential strain on the prospective profitability of the banking business. The results of the ECB/EBA comprehensive assessment confirm the regained resilience of Spanish banks in terms of generally adequate capital buffers after the implementation of the 2012-2013 financial assistance programme, although the projected drop in stressed capital ratios is non-negligible in individual cases.

The restructuring of banks having received State aid is well underway. Burden-sharing exercises are completed, and objectives under the 5-year restructuring plans have been already mostly achieved. In June 2014 the Commission approved the sale of NCG Banco to Banesco Group, and in July Catalunya Banc was sold to BBVA. Furthermore, preparations are under way to sell the FROB stake in BMN, possibly via an IPO early next year. In the case of Bankia, after the sale of 7.5% of the government's stake last February, the privatisation has so far not progressed further. The implementation of the savings bank reform has been relatively slow, as the secondary legislation implementing the savings bank law of December 2013 still has not been adopted.

SAREB's challenge of divesting its significant asset portfolio while maximising value remains significant. SAREB's divesting of assets continues at a moderate pace, concentrated in key areas such as Barcelona, Madrid, Malaga and Alicante. Despite the gradual stabilisation of real-estate markets in Spain, and despite the discount on the valuation of the portfolios that were initially transferred to SAREB from the banks, SAREB is still struggling to gain profitability. Going forward, a further sustained stabilisation of real-estate markets should allow SAREB to progressively gain profitability.

The implementation of other structural reforms to address macroeconomic imbalances has progressed further over the last six months, although unevenly across policy areas:

- **There has been some further progress in strengthening public finance management.** Spain is gradually implementing the public administration reform. The independent fiscal institution, AIReF, has started operation, albeit belatedly, and already issued a number of useful reports. A draft tax reform is currently in Parliament. The reform, which is centred on cuts in personal and corporate income taxes, can be seen as a first step towards a comprehensive simplification of the tax system but, not being budgetary neutral, it may complicate the achievement of the budgetary targets.

- **The implementation of measures to make active labour market policies more effective in contributing to the reduction in unemployment is moving ahead only gradually.** Due to shared competences and considerable inertia in the system, this is proving a complex and lengthy process, whose impact on the ground will take time to be felt. A new single job portal that was made operational in July should facilitate labour mobility within the country. Further temporary hiring incentives to youth employment have been established by the government. Reforms in the area of education and training aim at improving both learning outcomes and efficiency. Beyond the introduction in February of a temporary flat social security contribution on new and additional permanent contracts and the measures to promote indefinite hiring included in the 2013-2016 Youth Entrepreneurship and Employment Strategy, there are no new reforms in the pipeline to address the high degree of labour market duality. A sizeable increase in total social expenditure and specific measures to support weaker segments of the labour force have not proved sufficient to offset the impact of the crisis and of surging unemployment on social indicators. New measures to increase protection of the most vulnerable are being considered.

- **The insolvency framework is being modernised and the reform of the electricity sector is being completed; conversely, no progress has been made on the reform of professional services and associations.** The reform of the corporate insolvency framework should ensure coherence with the measures previously taken at the pre-insolvency stage and facilitate corporate debt restructuring. Implementation of the important law on market unity is advancing, but the pace of implementation could be enhanced. Licencing requirements in retail and, more generally, procedures for business start-ups have been eased, although there is still scope for facilitating further the creation of new businesses. The reforms in the gas and electricity sectors are helping to contain the tariff deficits. Yet, some flagship measures have suffered delays: the de-indexation law is still awaiting parliamentary approval, and, most remarkably, the law on professional services and associations has so far not even been submitted to Parliament. It is doubtful whether the planned set-up for the advisory council on future infrastructure projects will guarantee its independence.

On the basis of the analysis in this report, repayment risks for the ESM loan are very low at present. This assumes that the authorities continue to consolidate public finances and maintain the reform momentum to address the challenges to the economy. Borrowing conditions for the Spanish sovereign have considerably strengthened owing to policy actions at national and European level and restored confidence in the Spanish economy as well as its public finances.

1. INTRODUCTION

1. Spain exited successfully the financial assistance programme for the recapitalisation of financial institutions in January 2014. The Programme had been agreed by the Eurogroup on 9 July 2012 for a period of 18 months([2]) and provided an external financing by the euro area Member States of up to EUR 100 billion. Eventually, Spain used EUR 38.9 billion for bank recapitalisation, under restructuring and resolution plans approved by the EC under State-aid rules, and around EUR 2.5 billion for capitalising SAREB. Both the bank-specific conditionality and the horizontal conditionality included in the Memorandum of Understanding were fulfilled as scheduled.([3]) In July 2014, Spain made a voluntary early repayment of EUR 1.3 billion and a scheduled repayment of EUR 0.3 billion that was not used for the subscription of capital instruments of SAREB. As of October 2014, the outstanding amount of the European Stability Mechanism (ESM) loan is EUR 39.7 billion.

2. Staff from the European Commission (EC), in liaison with the European Central Bank (ECB), undertook the second post-programme review for Spain from 6 to 10 October 2014. The ESM participated in the meetings on aspects related to its own Early Warning System. Post-programme surveillance (PPS) aims at a broad monitoring of the repayment capacity of a country having received financial assistance.([4]) There is no policy conditionality under PPS, although the Council can issue recommendations for corrective actions if necessary and where appropriate. PPS is biannual in terms of reporting and missions. The first PPS mission took place in March 2014.([5])

3. In March 2014, under the Macroeconomic Imbalances Procedure (MIP), the Commission concluded that Spain is experiencing macroeconomic imbalances which require specific monitoring and decisive policy action.([6]) Following the conclusions of 2014 in-depth review (IDR), this PPS report also covers the specific monitoring of the policies recommended to Spain by the Council in July 2014([7]) in relation to the adjustment of these imbalances. An overview of the progress with the recommendations related to the MIP is provided in the Annex B. This report does not provide an assessment of fiscal policy, in order to avoid an overlap of surveillance processes.

([2]) However, the restructuring of the banks receiving public support under the State aid rules is expected to take up to five years.

([3]) For more details see the fifth review report: http://ec.europa.eu/economy_finance/publications/occasional_paper/2014/op170_en.htm

([4]) PPS is foreseen by Art. 14 of the two-pack Regulation (EU) N°472/2013. It starts automatically after the expiry of the programme and lasts at least until 75% of the financial assistance has been repaid.

([5]) For more details see the first PPS report: http://ec.europa.eu/economy_finance/publications/occasional_paper/2014/op193_en.htm

([6]) See Communication from the Commission to the European Parliament, the Council and the Eurogroup: "Results of in-depth reviews under Regulation (EU) No 1176/2011 on the prevention and correction of macroeconomic imbalances" COM/2014/0150 final

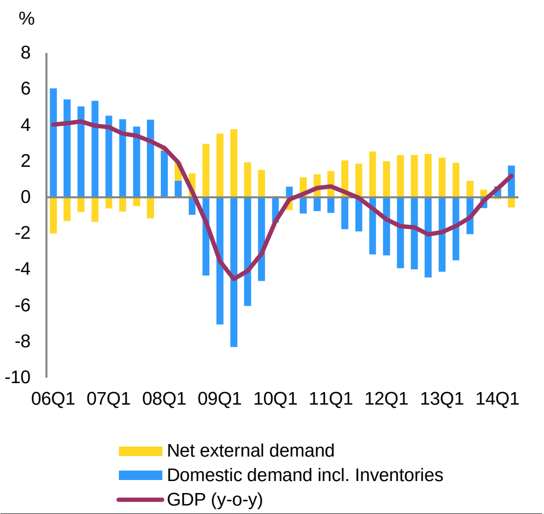
([7]) On a proposal from the Commission, the Council adopted country-specific recommendations to Spain in July 2014. See: http://ec.europa.eu/europe2020/making-it-happen/country-specific-recommendations/index_en.htm

2. RECENT MACROECONOMIC AND FINANCIAL SECTOR DEVELOPMENTS

2.1. RECENT MACROECONOMIC DEVELOPMENTS

4. Spain exited a long-double dip recession in the second half of 2013 and the economic recovery has since firmed up. Real GDP surprised on the positive side in the second quarter of 2014 when it grew by 0.6% q-o-q, after 0.4% q-o-q in Q1 2014. In y-o-y terms, GDP grew by 1.2% compared to 0.5% in Q1 2014. Growth has been driven by a robust contribution from domestic demand while the negative contribution from net external demand widened (see Graph 2.1). In particular, there was a sizeable rebound in private consumption, which is being boosted by improvements in the labour market. In turn, gross fixed capital formation accelerated strongly in Q2, as a result of the brisk pick-up of construction on the quarter. Both residential and non-residential construction investment improved significantly with respect to Q1. Conversely, equipment investment decelerated, although still growing by 8.7% on the year.

Graph 2.1: **Real GDP growth and contributions**

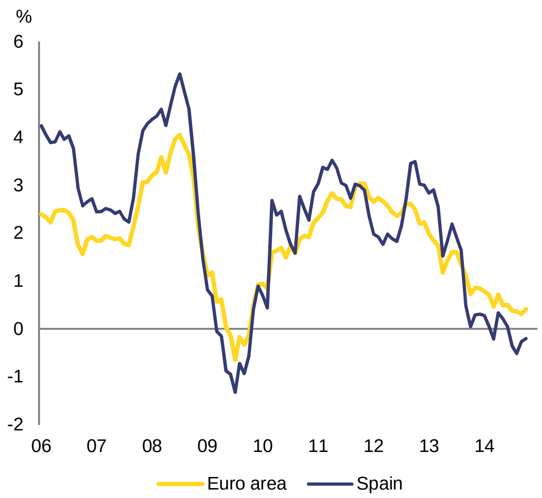


Source: INE

5. The weakening activity in the rest of the euro area poses risks to economic recovery in Spain. Domestic demand remains well underpinned by labour market prospects and gradually easing financing conditions as the stabilisation in wholesale financial markets is feeding through credit (see Section 2.2). However, the slowdown in the rest of the euro area is set to affect exports.

6. Inflation is expected to remain negative in the short term. HICP inflation was negative in the third quarter and is expected to remain at close to zero or negative rates in the coming months (see Graph 2.2). Apart from the fall of oil prices, low or negative inflation is mainly explained by the still large slack in spite of the recent pick-up in domestic demand.

Graph 2.2: **HICP inflation**



Source: Eurostat

7. The labour market is recovering but unemployment remains very high. According to the Labour Force Survey (LFS), after six years of negative growth rates, employment increased by 1.1% y-o-y in Q2 2014 and 1.6% in Q3 2014, while the labour force continued to contract. The unemployment rate fell by 0.8 pps. in the third quarter, although it remains very high at 23.7% and the situation remains particularly difficult as regards youth and long-term unemployment. The positive trends are confirmed with the data from the social security records. The number of workers affiliated to social security rose by 2.2% on the year in September, with registered unemployment falling by 5.9% y-o-y. While new indefinite contracts increased by 29.3% on the year in

September (now representing 8.5% of all new contracts), the temporary rate remains very high, at 24.6% in Q3 2014.

8. According to outturn data for the first half of the year, the 2014 deficit target (5.5% of GDP according to the Stability Programme, and 5.8% under the recommendation) appears within reach. This is also taking into account the favourable base effect from recent revisions to the 2013 deficit (0.3% of GDP, bringing the deficit down to 6.3% of GDP, net of bank recapitalisations). The general government deficit in the first half of the year was 3.4% of GDP, 0.3 pp lower than last year (net of bank recapitalisations). There are nevertheless risks to the 2015 deficit target of 4.2% of GDP. More generally, better economic conditions alone will not be sufficient for a timely correction of the excessive deficit by 2016, and additional consolidation measures will be needed. After the recent statistical revision (to bring the national accounts in line with ESA2010), public debt stood at 92.1% of GDP in 2013 and is expected to increase in 2015 to 101.2% % of GDP on the basis of the Commission Autumn 2014 Forecast, and 100.3% of GDP in the Spanish budgetary plan.

9. The household and corporate sectors are reducing their debt overhang. The total stock of private sector debt amounted to 182.1% of GDP in non-consolidated terms in Q2 2014 (73.7% of GDP household debt and 108.4% of GDP NFC debt), some 36.5% of GDP lower than the peak in Q2 2010.([8]) Most of the reduction is due to the 25.7% of GDP fall in debt of non-financial corporations since the peak. Credit contraction has been the main channel of private sector deleveraging, with aggregate bank lending on a declining path since 2007. Recent data show some deceleration in this contraction and confirm previous evidence that aggregate deleveraging is at least to an extent taking place selectively, with the financial sector ready to fund healthier corporations with positive growth prospects.

10. The external balance has deteriorated recently. Until the end of July, the current account balance recorded an accumulated deficit of 0.6% of GDP. By the end of the year the current account is projected to register only a modest surplus, compared to the 1.5% of GDP recorded in 2013. This sharp deterioration is mainly explained by strong imports as final demand recovers, whereas exports decelerated as a result of the slowdown in the main euro area economies. Much of the competitiveness lost prior to the crisis has been restored, but the import propensity remains high. Spain needs to run sizable current account surplus to reduce its large stock of net external debt (the net international investment position (NIIP) reached -92.9% of GDP at the end of 2013).

11. The housing market seems to be approaching stabilisation. For the first time since Q1 2008 unsubsidised housing prices rose in y-o-y term in Q2 2014, by 0.8% (and by 1.7% q-o-q). Prices of new dwellings went up by 1.9% y-o-y and those of used dwellings by 0.2%. In July 2014, the number of transactions on dwellings in land registries increased by 4.7% y-o-y. While these are tentative indications of a stabilisation, demand for housing remains weak and there is a large stock of unsold houses. The evolution of the housing market remains important for banks' future profitability and the success of SAREB. Given large regional differences in the evolution of the house prices before and after the boom, population determinants, as well as the stock of unsold houses, the time needed for the adjustment is likely going to vary across regions.

12. Overall, achieving sustainable GDP and employment growth while completing the adjustment of imbalances continues to pose a considerable policy challenge. The adjustment process is progressing but vulnerability to shocks remains large as stock variables (such as the accumulated debt) respond only slowly to a turnaround in flow variables (such as net credit flows). Moreover, the full effect of reforms already adopted is probably not yet fully felt, and there are several important ones that are still in the implementation phase (see Section 4.2).

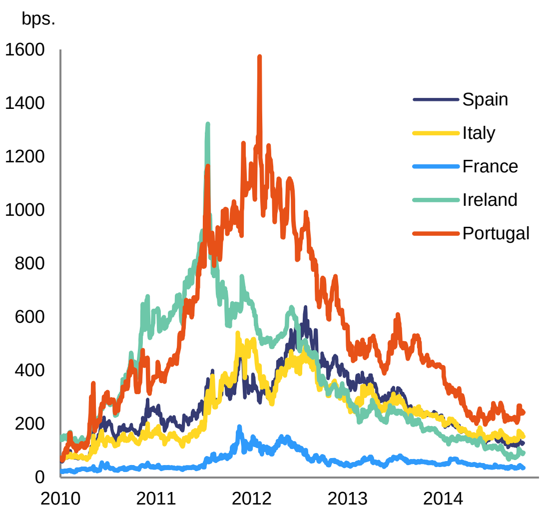
2.2. FINANCIAL SECTOR DEVELOPMENTS

13. Financial markets stabilised further, amid rising asset prices, and systemic risk in the financial sector subsided. In mid-October the 10-year government bond yield fell to a record low

([8]) In consolidated terms, the NFC debt decreased from 118.9% in Q2 2010 to 95.2% in Q2 2014. Financial derivatives are excluded from debt calculations.

of 2.1%, compared to 6.4% at the beginning of July 2012. The 10-year spread over the German bund also fell, to around 120 basis points, but bounced back temporarily to around 140 bps during the market turbulence in mid-October (see Graph 2.3). 5yr CDS spreads went down to below 100 basis points, but also displayed increased volatility recently. Share prices continued to trend upwards, including for several Spanish banks until the recent sell-off. Bond yields and asset prices reacted positively to the results of the ECB asset quality review and stress test on 26 October 2014.

Graph 2.3: **Euro area sovereign spreads to the 10-year German bund**

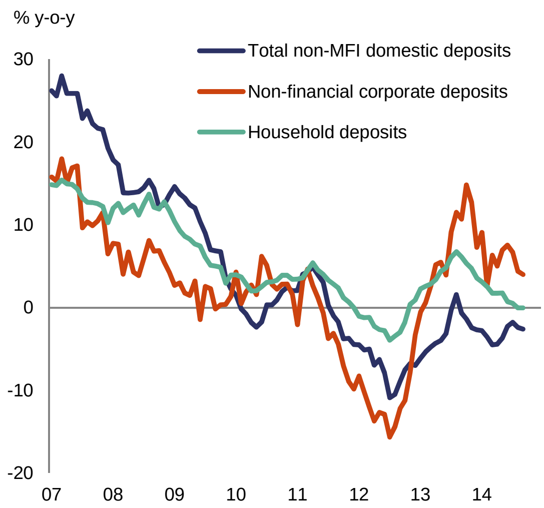


Source: IHS Global Insight and own calculations

14. In general, Spain has benefitted from a return of investor confidence and better market sentiment. This is a consequence of bold financial sector reforms over the last two years that have led to recent favourable developments in the Spanish economy and banking sector, amid a further stabilisation of euro area financial markets. Nevertheless, Spain did not escape from the recent market turmoil, showing that like other economies it remains vulnerable to sudden changes in global investor sentiment.

15. The liquidity of the Spanish financial sector continued to improve. As regards the funding structure of banks, deposits continue to grow, though at a slower pace, and wholesale funding reliance is gradually decreasing. Total deposits of households and non-financial companies (NFCs) increased by about 1% y-o-y in August 2014 (see Graph 2.4), with NFCs deposits growing at about 4% y-o-y, while household deposits were flat. The stagnation of household deposits reflects a growing preference for alternative investment vehicles, such as mutual and pension funds, in a context of low bank deposit interest rates.

Graph 2.4: **Bank deposits**

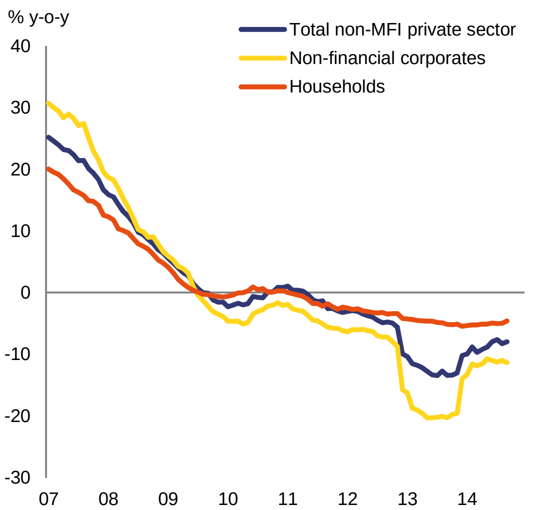


Source: BDE

16. Spanish banks' reliance on Eurosystem funding decreased continuously from its record EUR 400 billion in mid-August 2012. Banks' total net debt with the Eurosystem amounted to EUR 150 billion in October 2014, down by over EUR 250 billion from its peak. Spanish banks have reduced their share in total Eurosystem borrowing from around 44% in August 2012 to 30%. Bank debt issuance on wholesale markets stagnated in July and August 2014, following to a great extent the seasonal effect of a usual summer decline. The three-month repo rate decreased to close to 0%, comparable to rates in other euro area countries.

17. Private credit is still contracting, although there are some segments, notably lending to SMEs, for which new credit is growing. The decline in lending activity has decelerated in recent months in line with the economic recovery, although the main credit indicators are still in negative territory. The decline in the stock of private domestic credit continued but decelerated marginally to around 7.2% y-o-y as of September 2014. Credit to households was declining by around 4.6% y-o-y while credit to non-financial corporates (NFCs) was still shrinking by about 11.3% (see Graph 2.5). If external borrowing and issuance of bonds are also taken into account, the rate of contraction in the total stock of financing to NFCs decelerated further to 5.9% y-o-y as of August 2014. As regards the flow of new lending, a steady improvement can be noticed in the case of credits below EUR 1 million (a proxy of credit to SMEs) which were growing at almost 10% (y-o-y, 3-month moving average) as of August 2014. By contrast, the granting of new loans of above EUR 1 million remains volatile and on a downward trend. A number of banks participating in the TLTROs programme intend to pass on the funding benefit to new SME clients.

Graph 2.5: **Bank loans to the private sector**



Source: BDE and own calculations

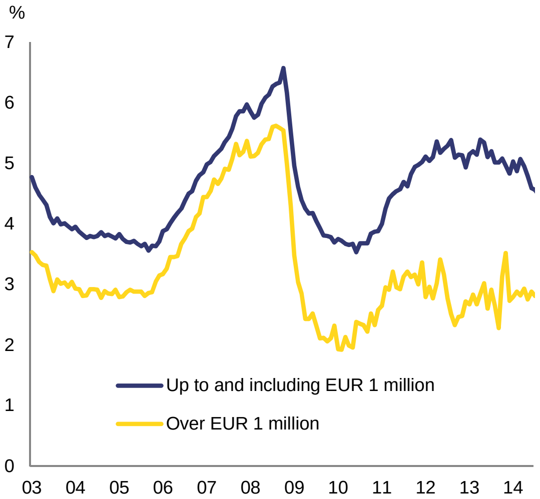
18. Access to finance for companies and households is improving according to the Bank Lending Survey([9]). During the first two quarters of 2014, banks relaxed somewhat their credit standards for approving loans to NFCs, and in particular for SMEs. This trend continued in the third quarter of 2014, as also indicated in the October Bank Lending Survey of the ECB. At the same time, banks report a significant decrease in their margins on loans for both SMEs and large companies and a relaxation of collateral requirements. The reported rise in the supply of credit comes in time to match an increase in the demand for loans, which strengthened visibly in the first three quarters of 2014. The loan demand by NFCs is likely to continue to rise, although for the time being it is driven by short-term investment in inventories and working capital rather than by fixed investment. The survey also indicates a reduction in the cost of mortgage and consumer credit for households as well as a significant increase in the demand for consumer credit, consistent with the recovery of internal consumption.

19. In line with general developments in the euro area, access to finance has become less of a concern also for Spanish SMEs. The percentage of respondents considering it the most pressing problem declined from close to 30% to 18% in the latest round of the SAFE survey([10]) (October 2013-March 2014), which marks one of the biggest drops in the euro area over that period. The significant decline in the cost of new credit since the beginning of the year is another sign of the improved access to finance. The average interest rate for loans to NFCs above EUR 1 million dropped by about 50 bps to 2.25% as from end-2013 to July 2014, whereas the one for loans below EUR 1 million recorded a bigger decline of around 100 bps to 4.2% over the same period (see Graph 2.6).

([9]) See the report at: http://www.bde.es/webbde/en/estadis/infoest/epb.html

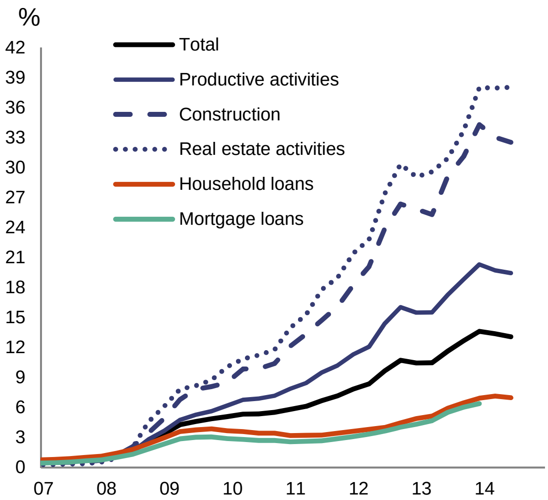
([10]) Survey on the access to finance of small and medium-sized enterprise in the Euro Area at: https://www.ecb.europa.eu/stats/money/surveys/sme/html/index.en.html

Graph 2.6: **Bank interest rates for loans to NFCs**



Source: Source: ECB

Graph 2.7: **Non-performing loans**



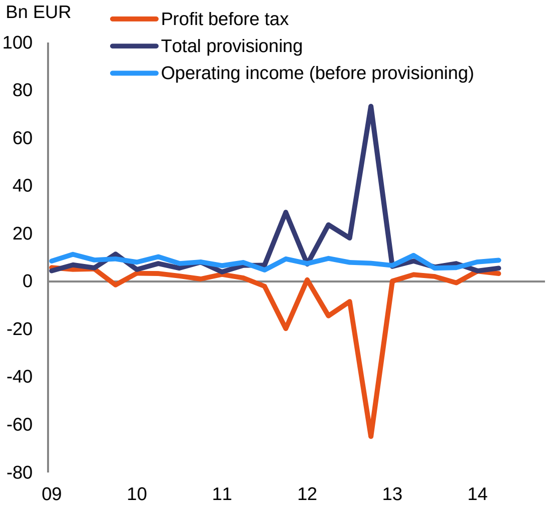
Source: BDE and own calculations

20. The deterioration in banks' asset quality came to a halt in the first half of 2014. The non-performing loans ratio (NPLs) at system level decreased from 13.6% at the end of December 2013 to 13.1% at the end of June (see Graph 2.7). The stock of impaired assets went down by EUR 10.9 billion between December 2013 and June 2014 as banks continued the process of disposal of impaired assets, whereas the reduction in the total loan portfolio amounted to roughly EUR 25.2 billion during the same period. Non-performing loans for construction activities, which account for the highest share in the total non-performing loans, are currently on a declining trend.

21. Restructured/refinanced loans accounted for 14.2% of the total loans to the private sector at the end of June 2014. Based on the classification criteria of Banco de España (BdE), 49.5% of restructured/refinanced loans were classified as doubtful, 18.7% as substandard and 31.9% as performing loans. Similar to the case of non-performing loans, refinanced and restructured loans show a high degree of concentration in real estate (23.3% in construction and 25.5% in mortgages).

22. After banks' profitability turned positive in 2013, the Q1 2014 results were much better than in Q1 2013 in a challenging operating environment. Spanish banks increased their profits in the first quarter of 2014 (see Graph 2.8) above their quarterly results in 2013 despite shrinking credit volumes and a low-interest-rate environment. Net interest income was slightly lower than in 2013, but an increase in non-interest income led to gross income being more than EUR 1 billion higher than in Q1 2013. Together with further reductions in operating expenditures and provisioning, it led to a profit before tax of around EUR 4.2 billion, which is slightly higher than the corresponding amount recorded over the whole year in 2013. Nevertheless, profitability remains thin and will be under pressure going forward. With limited room of manoeuvre on interest rate spreads, the only sustainable solution is to increase business volumes as the economy recovers. On the positive side, the significant restructuring efforts undertaken during the last 4-5 years have turned the Spanish banking sector into one of the best in Europe in terms of operating costs, efficiency and return on equity.

Graph 2.8: **Bank profits**



Source: BDE

23. Spanish banks' capital levels rose further during the first half of 2014. The new CRR([11]) common equity tier 1 capital stood at 11.6% in June 2014. Total regulatory own funds ratio increased to around 13.5%. In view of the results of the asset quality review (AQR) and the stress test (ST) and in order to shore up further their capital levels, some banks have managed to raise equity or other non-core capital instruments such as subordinated debt or contingent capital instruments that qualify as own funds. In addition to this, BdE extended its recommendation on a maximum 25% of paid-in-cash to be also applied during 2014, leading to a reinforcement of Spanish banks' core capital.

24. The outcome of the ECB comprehensive assessment confirms the regained resilience of Spanish banks after the implementation of the Financial Assistance Programme. On 26 October, the ECB and the EBA disclosed bank-by-bank results of their comprehensive assessment of the major European institutions carried out over the last year. It comprised an asset quality review followed by a bottom-up stress test. The final outcome of the stress test amounted to a capital shortfall of EUR 25.2 billion under the adverse scenario across 25 banks within the euro area. The 15 most significant Spanish credit institutions, covering more than 90% of the banking system, were assessed. The reference date for the assessment was 31 December 2013. As of that date, only one former savings bank, Liberbank, failed to be above one of the three capital thresholds envisaged in the ECB methodology, showing a very small shortfall of EUR 32 million stemming from the asset quality review. However, this institution managed to raise fresh equity amounting to EUR 637 million already during the first half of 2014 and therefore needs no additional capital to meet the comprehensive assessment minimum requirements. The other 14 Spanish banks were assessed to be well above the critical threshold of 8% for the Common Equity Tier 1 capital ratio after asset quality review adjustments as of December 2013 and remained above 7.5% under the adverse scenario, thus exceeding the minimum 5.5% required, while five institutions were above 9%, including BFA-Bankia. The results confirm the rigour of the asset quality review and stress test carried out in 2012, the positive impact of financial reforms comprising high levels of additional provisions in 2012 and 2013, underscore the significant stabilisation efforts made since the start of the programme and should reinforce the confidence of markets in the Spanish banking sector at large. This notwithstanding, the stress test impact on individual banks turned out to be non-negligible, thus underscoring the need to remain vigilant.

([11]) Capital Requirement Regulation.

Box 2.1: Final results of the ECB comprehensive assessment

Scope of the ECB comprehensive assessment

- The **ECB conducted during the last months a comprehensive assessment (CA)** on the most significant EA banks. The assessment started in November 2013 and took 12 months to complete. The consulting company Oliver Wyman provided technical assistance and support to SSM teams during the exercise. The reference date for the assessment is 31 December 2013.
- The scope of the exercise included **15 Spanish credit institutions** (out of 130 credit institutions across 18 Member States), **covering around 90% of the banking sector**. The CA consisted of two main elements:
  - an **asset quality review (AQR)** assessing banks' asset classifications and collateral valuations, as well as the adequacy of their loan-loss provisions, capital and leverage. The benchmark for the AQR was 8% of Common Equity Tier I (CET1) CRR definition.
  - a **stress test (ST)**, in coordination with the EBA, assessing the resilience of banks' balance sheets under forward-looking 3-year baseline (8% CET1) and adverse scenarios (5.5% CET1).

Outcome of the exercise

- **The necessary adjustment to banks' balance sheets, triggered by the findings of the AQR were quite small in Spain,** and relative to the respective aggregate balance sheets of banks, actually the lowest among all euro area Member States. **None of the Spanish banks will have to raise additional capital** to meet the minimum threshold set up by the ECB for the CA.
- **One former savings bank, Liberbank**, out of the 15 institutions examined **failed to pass the CA as of 31 December 2013. It showed a small capital shortfall of EUR 32 million** to the threshold of 8% for the AQR adjusted CET1 ratio. However, **it increased capital by EUR 575 million in June 2014 and benefited from the voluntary conversion of contingent capital amounting to EUR 62 million, so no additional capital will be required.**

Bank-by-bank results

Credit institution	**CET1 ratio end point after CA** (2016 adverse threshold: 5.5%)	**CET1 amount (m EUR) end point after CA** (2016 adverse thres: 5.5%)	**CET1 (-) shortfall/(+) surplus** (m EUR, most conservative scenario[1])	**Actions taken** since Jan 2014 (m EUR)	Info: reported **2013 CET 1 ratio**
Kutxabank	11.8%	4,254	+2,270	-	12.1%
Bankinter	11.0%	2,708	+1,353	13	12.0%
Bankia	10.3%	10,225	+4,763	991	10.7%
Caixabank	9.3%	16,480	+6,779	1,923	10.3%
NCG	9.1%	2,093	+814	-	10.3%
BBVA	9.0%	34,196	+13,223	-	10.7%
Unicaja-CEISS	8.9%	2,990	+1,140	-	11.1%
Santander	8.9%	50,460	+19,442	-	10.4%
Sabadell	8.3%	6,661	+2,265	6	10.3%
BMN	8.1%	1,662	+531	-	9.4%
Cajamar	8.0%	1,900	+592	50	11.0%
Catalunya Banc	8.0%	1,415	+444	-	12.3%
Ibercaja	7.8%	2,161	+640	-	10.0%
Popular	7.6%	6,434	+1,756	120	10.6%
Liberbank	5.6%	1,040	-32	637	8.7%

[1] Depending on the bank the worst result is presented. For example in the case of Liberbank, the shortfall stems only from the AQR at the end of 2013.

Box (continued)

3. FINANCIAL SECTOR RESTRUCTURING AND REFORM

3.1. PROGRESS WITH BANK RESTRUCTURING

25. The effective implementation of the restructuring plans of State-aided banks is well underway. The burden-sharing exercises have been completed**.** In terms of capacity, the entities continue working to reach their operational targets by re-sizing branches and workforces, and have already done so in terms of lending volumes. Some banks accelerated the planned implementation in order to devote as soon as possible all efforts to the ordinary management of their banking business. As regards the required divestments of subsidiaries, banks are mostly on track although some specific sales are delayed, mainly due to the difficulty of selling real estate companies or to sell/liquidate not fully owned subsidiaries. The monitoring of restructuring plans will continue in the coming years, including possible adaptations to significant market changes in duly justified situations. The main challenges relate to the disposal of the remaining FROB([12])-owned banks.

26. Banks are adjusting their balance sheets and credit portfolios at a good pace in order to reach a balanced and sustainable business structure. Liquidity and funding positions continue the positive trend observed in previous months, with lower loans-to-deposits (LTD) ratios and a decreasing recourse to ECB funding for most of the entities. In terms of solvency, the capital injected in the banks and the loan-loss provisions set aside in 2012 and 2013 provide a comfortable buffer, with the situation being continuously monitored by the supervisors to assess possible weaknesses in specific situations.

27. On 20 June 2014 the Commission approved the revised restructuring plan for NCG Banco following the sale to Banesco Group. In December 2013 Banesco, a banking group based in Venezuela, won a tender for the sale of NCG Banco. The European Commission concluded that the sale process and the proposed amendments to the restructuring plan were in line with EU state aid rules. The revised restructuring plan is, overall, consistent with the principles of the original restructuring plan. It will allow NCG Banco to return to long-term viability through its integration into a sound credit institution. NCG Banco will also continue to fundamentally change its business profile, winding down non-core and riskier activities and becoming a regional bank in the north of Spain, trading as Abanca, and focusing on traditional banking activities.

28. The return of Catalunya Banc to private ownership is currently underway. In June 2014, the FROB launched the sale of Catalunya Banc. The auction was completed in July 2014, with BBVA, one of the main Spanish banks and an international banking group, emerging as winner. In parallel, and in order to support that auction process, Catalunya Banc sold a portfolio of loans, mainly mortgages (with an outstanding nominal value of EUR 6.4 billion, and book value of EUR 4.2 billion) to Blackstone, one of the world's leading investment firms, at an effective price of EUR 3.6 billion. The European Commission is currently assessing these transactions under state aid rules with a view to agree with BBVA on an amended restructuring plan for Catalunya Banc.

29. The FROB started the re-privatisation of Bankia in 2014. On 28 February 2014, 7.5% of the shares held in Bankia by BFA were sold on the market through an accelerated book building exercise. Since then no further privatisation of parts of Bankia has been carried out or announced. Possible future disposals or divestment strategies are under discussion, but have not yet been advanced.

30. Other FROB-owned banks plan to tap capital markets in the future. Other mid-sized banks in which the FROB has a stake have accessed the capital markets as a way to repay the financial assistance provided by the FROB (the case of Liberbank) or may do so to allow the FROB to sell its equity stake in the bank along with other existing investors.

3.2. SAREB – RECENT DEVELOPMENTS AND OUTLOOK

31. SAREB continues to operate under difficult market conditions which, combined with the quality of its assets, have had an adverse impact on its financial results in 2013 and the first half

([12]) *Fondo de **R**eestructuración **O**rdenada **B**ancaria* (Fund for orderly bank restructuring) http://www.frob.es

of 2014. Earnings before interest, taxes, depreciation and amortisation (EBITDA) in the first half of 2014 amounted to EUR 429 million, compared to EUR 348 million in the corresponding period of last year. Most of the gross margin (87%) comes from financial assets and the remainder from the real estate assets. SAREB has repaid EUR 2 billion of senior debt this year, lowering the level of senior debt by 4%.

32. The financial results for the first half of 2014 are lower than foreseen by the budget. However, due to some market seasonality and a possible spike in sales in the second half of the year, the management has decided not to modify the budget. These results do not include asset impairments, which will have a negative impact on the profit and loss account. The rules for the updated valuation of assets and the impairment estimates are yet to be issued by Banco de España (BdE) and published in a Circular([13]). The impact of new accounting rules on financial results may imply the revision of the business plan.

33. One of the main challenges for SAREB is the change of servicers for its assets. The change was necessary as the current servicing contracts expire at the end of 2014 and the service could benefit from further improvements. SAREB decided to set up a new system that would allow better service at competitive prices. The main change will entail a strengthening of incentives by putting more weight on the variable components of the remuneration. The new system is also likely to ensure a better knowledge of assets by the managing entity as well as better coordination between projects. SAREB launched a public competitive process (project Ibero) covering the entire portfolio of SAREB. All the servicing platforms with capability to offer the service had been invited to participate. The process is currently in its final stages. The first servicer, which will be dealing with a portfolio of 42,900 assets for a period of seven years, has already been selected. Further selections should be announced in the coming weeks. Migration to new servicers will start at the beginning of 2015. In the meantime, asset portfolios will be managed by the current entities.

34. The main source of uncertainty for SAREB is related to real estate market developments. The recent data point to stabilisation of prices and increase in sales on the housing market. However, market developments vary across regions and in the areas with the highest sales growth, the competition among sellers is the highest, resulting in lower margins for SAREB. Additionally, other sources of uncertainty for SAREB in the nearest future are the new accounting rules for asset valuation, which may result in additional impairments, and the change of servicers, as the portfolios will have to be transferred to new servicers.

3.3. PROGRESS WITH FINANCIAL SECTOR REFORMS

35. Law 26/2013 in December 2013 created a new legal framework for the Spanish savings banks. Its full implementation requires the issuance of subordinated legislation, namely a Circular del Banco de España (CBE) which is in public hearing procedure until November 18. The CBE has developed important aspects of the Law, mainly in cases where banking foundations have stakes of above 30% in banks and in cases of controlling stakes. Furthermore, the Circular contains provisions on the management protocol and the financial plan to be presented by banking foundations as well as the reserve fund to be constituted by banking foundations with controlling stakes in banks. Additionally the Ministry of Economy is currently working on a Ministerial Order to establish the reporting procedures on corporate governance of banking foundations.

36. The obligation to set up a reserve fund is one of the key elements of the Law 26/2013. The purpose of the reserve fund is not only to meet the possible capital needs of the participating banks, but also to provide an incentive for banking foundations to disinvest in the banks under their control. In fact, Law 26/2013 provides that those banking foundations which will present a disinvestment plan to reduce their stake within five years to below the control levels, do not have to set up the reserve fund. The law further stipulates that

([13]) As foreseen in the Law 9/2012, A.D. 7ª, 10, introduced by Law 26/2013. The Circular outlining the accounting rules is expected to be issued by Bank of Spain in the last quarter of 2014 and will apply already to the 2014 financial statements.

such reserve funds should not be accounted as capital by banks in order to compute their solvency ratios or to assess their capitalisation plans.

37. The CBE will be approved with delays compared to the initial schedule. The adoption of the CBE is expected for the first part of 2015, which implies a delay in relation to the initial plans at the time of the approval of the Law and also in relation to the calendar previously provided by BdE. In light of the arguments presented above, the approval of the CBE is key for the succesful completion of the reform of the savings banks sector in Spain.

38. The transposition of the CRD IV/CRR and of the EU Bank Recovery and Resolution Directive (BRRD) is on track. Regarding the solvency regulation, the Royal Decree and the Circular of BdE, completing the transposition of the CRD IV already initiated by Royal Decree-Law 14/2013 and Law 10/2014, are on track and will be tentatively be approved at the beginning of 2015. The Law 9/2012 on the resolution of credit institutions will be adjusted in line with the BRRD. The Spanish authorities are working on the first draft, which is planned to be launched for public hearing by the end of the year. The Spanish authorities are currently discussing the institutional framework. The BRRD allows Member States to choose between two models: total separation between the national resolution authority (NRA) and the supervisor or allocating the resolution authority within the supervisor.

39. Measures to strengthen non-bank financial intermediation are starting to have tangible results. The Instituto de Crédito Oficial (ICO)'s on-lending activity to SMEs via commercial banks accelerated further, reaching an all-time record. As of 30 September 2014, banks granted around EUR 21 billion of new ICO loans during the prior 12 months, which corresponds to a market share of about 15%. It has helped reduce the average interest rate on new loans to NFCs to 4.5% as of August 2014. A second tender finalised by ICO Fond Global in May 2014 led to the creation of additional eight new venture capital and private equity funds. The funds are planned to mobilise about EUR 3.8 billion of capital. A third tender is underway for nine tickets (two incubator funds, two venture capital funds, three growth capital funds and two lending funds) to be awarded in November 2014. During its first year of operation, the alternative bond market MARF saw eight debt issuances of about EUR 370 million in total. In July 2014, the government adopted a draft law regulating venture capital companies and closed-end collective investment schemes. The draft law aims at reducing administrative procedures for venture capital companies and at transposing the EU Directive on alternative investment fund managers. In October 2014, the government also adopted a broad-based law on promoting corporate financing. The law aims at improving (i) the portability of financial information for SMEs, (ii) the CERSA regime of mutual guarantees, (iii) the regime for securitisation, (iv) the transit between the alternative and traditional stock markets, (v) the issuance of bonds by NFCs, and (vi) introducing a regime for crowdfunding.

40. Joining the Single Supervisory Mechanism (SSM) entails significant changes for the supervisory procedures of BdE. BdE has completed a reorganisation of its Directorate General Banking Supervision with the aim to mirror the organisation of the SSM in order to ensure a smooth cooperation with the latter. BdE has also made an assessment of the number of necessary staff to ensure the appropriate supervision of credit institutions in the context of the new European supervision framework. Joint Supervisory Teams (JSTs) with the SSM have been set up and have started to operate. Furthermore, the SSM and BdE are in the process of defining the 2015 supervisory plan. The ECB is also in the process of completing its working procedures, which will entail an adaptation of BdE to these procedures.

3.4. CHALLENGES AHEAD

41. The current low interest-rate environment and the weak economic outlook in the euro area could jeopardise the recovery experienced in banks' profitability and especially in their interest incomes. Spanish banks are particularly exposed to mortgage loans, usually granted at a floating rate linked to the Euribor. Despite the fact that funding costs have substantially decreased during the last quarters due to cheaper deposits and wholesale funding, the low interest rate environment could damage banks' net interest margins. In addition to this, the weak economic outlook for the euro area (and some emerging economies) could endanger long-term sustainable profitability. On the positive front, non-performing loans are now decreasing, and the ECB's comprehensive assessment has overall assessed positively the solvency and resilience of the banking sector under a potential adverse macroeconomic scenario, and banks are benefitting from the effort made as regards the streamlining of operational costs in general.

42. The full implementation of the Law 26/2013 on savings banks needs the approval of a Circular del Banco de España. This CBE has to develop the requirements set up by the Law, mainly those for banking foundations with majority control stakes in banks. Such requirements are crucial in order to finalise the reform of the savings banks and achieve the orderly reduction of the stakes of banking foundations in banks, as clearly set up in the preamble of the Law.

4. PROGRESS ON POLICY MEASURES RELEVANT FOR THE CORRECTION OF MACROECONOMIC IMBALANCES

This chapter gives an update of measures taken in response to the 2014 country specific recommendations (CSRs), which are relevant for the macroeconomic imbalances procedure (MIP). More details by single reform item can be found in the table annexed to this report.

4.1. MEASURES TO IMPROVE THE QUALITY OF PUBLIC EXPENDITURE AND TAXATION AND THE EFFICIENCY OF PUBLIC ADMINISTRATION

43. Progress has been achieved to strengthen further public finance management, but some fiscal structural measures have not yet been fully applied. The application of some preventive and corrective measures set out in the Budget Stability Organic Law for regions which have not complied or are at risk of non-compliance with fiscal targets has been weaker than last year. The planned tax reform, while providing some simplification to the tax system, may render fiscal consolidation more difficult. Spain is gradually implementing the public administration reform, and various general government sub-entities have started publishing their average payment periods according to a common methodology. The independent fiscal authority, AIReF, has become operational and issued its first reports.

44. Compliance with deficit targets is likely to vary across general government subsectors. Regional governments will in all likelihood not reach the 1% deficit target for 2014. In particular, budgetary execution data of regional governments up until August 2014 shows a deficit of 1%, 0.2 percentage points higher than in the same month of 2013. Despite visible deterioration in regional public finances throughout the year, no preventive measures foreseen in the Budgetary Stability Organic Law had been enforced on regions at risk of non-compliance at the time of writing. In addition, compared with last year, the adoption of corrective measures is going at a slower pace,([14]) with only one of six Economic and Financial Plans having been approved. Admittedly, the amended Budgetary Stability Organic Law sets out a two year period – i.e., the current and subsequent year – to achieve compliance with the targets and earmarked revenues to regional governments under the current financing system are set to increase in 2015. However, any deviation in the budget outcome will carry on to 2015, thus making it difficult to comply with an even more demanding fiscal target.

45. The publication of comparable data on public sector commercial arrears will enable the actual enforcement of the legal provisions on late payments. Spain's stability law was amended in December 2013 to ensure that all general government subsectors comply with the 30-day average payment period for commercial debt, in accordance with applicable EU legislation. To that end, the amendments mandate all administrative bodies to publish periodically their average payment period on their website and set out a procedure to monitor compliance by the ministry of finance. The first average payment period data calculated according to a standard methodology started to be published at the end of October 2014, more than ten months after the entry into force of the law. With this publication comes the launch of the legal procedure to ensure compliance with the average payment period target.

46. On 1 August, the government approved the draft tax reform proposal, which is to be adopted by parliament by the end of 2014. The tax reform focuses on cuts in personal income taxes (PIT) and corporate income taxes (CIT) and is thus not as comprehensive or ambitious as it could have been. It is a partially missed opportunity to simplify significantly and fix shortcomings in the tax system and to sustainably lower labour taxation by shifting the tax burden to indirect taxes (consumption or environmental) or recurrent property taxes. Positive elements of the reform are (i) some reduction of the labour tax wedge, however with a short-run impact mainly on disposable income (and hence consumption and imports) rather than on labour costs (and thus employment), (ii) measures to broaden the corporate tax base and reduce the debt bias, and (iii) measures to reduce tax fraud. Not being revenue neutral (the ex-ante cost is estimated by

([14]) This refers namely to the approval by the Financial and Fiscal Policy Council of economic and financial plans for regions having not reached their 2013 deficit target.

the government at 0.9% of GDP), the reform makes fiscal consolidation more difficult.

47. Spain is gradually implementing the public administration reform. The reform aims to achieve efficiency gains and fiscal savings. It aims to (i) reduce duplicated administrative structures within the central government and between the central and regional governments; (ii) reduce administrative burdens; (iii) streamline overheads and (iv) rationalise the central government's "institutional" administration.([15]) As of September 2014, 101 out of 212 public administration reform measures had already been implemented (45.5% of the total number of measures), and only four measures were at an initial stage. Given that large regulatory and spending powers are devolved to regions, regional ownership of the reform is critical to its success.([16])

48. Spain's independent fiscal authority (AIReF)([17]) is now operational. AIReF's legal framework is virtually complete. However, secondary legislation to implement the legal mandate of securing access to the information AIReF needs to carry out its duties was pending at the time of writing. AIReF's staffing, other than its managing board – i.e., president and three directors – took place during the summer of 2014, eight months after its creation in law (see annex B for more details). However, this has not prevented the authority from publishing various reports and opinions, including on the 2015 macroeconomic and budgetary forecasts.([18]) Recommendations given by AIReF in its reports and opinions are not legally binding on their addressee. However, if the addressee of an AIReF report resolves to ignore its advice, he/she is to explain why. In order to increase the effectiveness of AIReF's reports and in conformity with common principle no. 7 on national fiscal correction mechanisms,([19]) the law could require the addressee of AIReF reports to publish such explanations.

4.2. MEASURES TO FOSTER STABILITY OF THE FINANCIAL SECTOR AND ORDERLY DELEVERAGING OF THE PRIVATE SECTOR

49. A revision of the insolvency framework to facilitate corporate debt restructuring is underway. Since the adoption of the 2014 CSRs, this has been the most significant reform aimed at supporting corporate deleveraging. Inefficiencies in personal and corporate insolvency procedures may delay private sector deleveraging and the re-allocation of resources by impeding swift recognition and work-out of unsustainable private debt or by unnecessarily pushing viable firms into liquidation. Other measures to foster stability of the financial sector and progress in its restructuring are discussed in Chapter 3 of this report.

50. The insolvency framework has been reformed to facilitate corporate debt restructuring. Two significant reforms of the corporate insolvency framework have been adopted in 2014 to reduce the proportion of firms in insolvency proceedings which are being liquidated. In March, the Royal Decree-Law (RDL) 4/2014 focused on extending available options for restructuring in pre-insolvency procedures. In September, the RDL was passed into law including amendments to the insolvency administrators' regime. Also in September,

([15]) To note: regional governments are pursuing their own policies to streamline their institutional sector. The Ministry of Finance published on 31 July 2014 a report on the rationalisation of the so-called institutional administration, as of 1 January 2014. The report shows there has been progress in terms of the number of entities liquidated and monetary savings achieved. The number of entities appended to regional governments is expected to be 1,579 following the completion of the reorganisation process (down from 2,369 in July 2010). However, regions have contributed unevenly to the reduction effort (either in the number of entities liquidated or in terms of savings generated), with highest reported savings in Valencia, Madrid and Catalonia. Around 30% of entities that disappear are merged or integrated into existing or newly created entities. At the cut-off date of the report, some regions (notably Andalusia and Extremadura) had followed extensively this practice.

([16]) To illustrate, regarding planned reforms to streamline central government overheads, Chapter VI of the report on public administration reform (*subcomisión de gestión de servicios communes*) acknowledges that the recommendations are addressed to the central government. However, the report invites regional governments to apply the recommendations as necessary.

([17]) Autoridad Independiente de Responsabilidad Fiscal, Independent authority for fiscal responsibility, www.airef.es

([18]) AIReF published an opinion on changes to the budgetary cycle procedures, an opinion on debt sustainability, a report on economic and financial plans of six regions, and a report on government's macroeconomic forecasts for the 2015 State budget.

([19]) See common principles on national fiscal correction mechanisms at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2012:0342:FIN:EN:PDF

RDL 11/2014 revised the in-court debt restructuring procedures along the lines of the changes in pre-insolvency procedures and offered options to promote liquidation as a going concern (transferring the business as a whole) instead of a piecemeal liquidation. The RDL is now in Parliament to be passed into law, with the possibility of some fine-tuning. According to the authorities, some shortcomings of the out-of-court agreements on payments introduced with the Law 14/2013 will be tackled during the parliamentary approval of the RDL 11/2014, to make the agreements more interesting for SMEs.

51. The reform gives new instruments to the parties negotiating in insolvency procedures. The reform gives the possibility to extend the agreements to secured or dissenting creditors. It remains to be seen how far creditors will be ready to enter into agreements. The authorities are convinced that adoption of RDL 11/2014 will support the effectiveness of the March measures, as both pre-insolvency and insolvency procedures are now aligned, and creditors have stronger incentives to reach agreements already in the pre-insolvency phase. The RDL 11/2014 sets up a monitoring committee to assess the impact of the adopted reforms and, if needed, to introduce new measures. Some efforts are ongoing to make insolvency proceedings more attractive for sole proprietors and for SMEs. The Court of Justice of the EU declared certain Spanish procedural rules incompatible with EU law, as they did not provide a sufficient protection against unfair terms in consumer contracts. To address the rulings, the authorities have revised the mortgage protection legislation. They are of the view that further reforms of the mortgage foreclosure legislation should sufficiently take into account the concerns of the proper functioning of the mortgage market, including mortgage-backed securities and the stability of the banking sector.

4.3. MEASURES TO IMPROVE THE FUNCTIONING OF THE LABOUR MARKET AND ENHANCE HUMAN CAPITAL

52. Some measures have been recently taken to reform employment services, foster labour mobility and introduce hiring incentives with a focus on the youth. Work is ongoing to make active labour market policies (ALMPs) more effective in contributing to the reduction in unemployment, as recommended in the 2014 CSRs. However, due to shared competences and considerable inertia in the system, this is proving a complex and lengthy process, whose impact on the ground will take time to be felt.

53. The temporary reduced employers' contribution to the social security has had a limited impact so far. The measure, introduced in February 2014 and expiring at the end of the year, features a temporary single monthly contribution to social security of EUR 100, which may benefit all firms and self-employed, during 24 months, when the subsidised job increases the level of net indefinite employment and is maintained for at least three years. The measure thus applies to either new indefinite contracts or the conversion of temporary into indefinite contracts. According to the Ministry of Labour and Social Security, the new scheme will reduce by 75% the current total contributions to social security. The scheme was forecast to have a positive impact of 0.3% on GDP and 0.3% on employment in the first year. Provisional data (up to July 2014) point to approximately 111,000 indefinite contracts (or 20% of all the indefinite contracts signed since the reduced contribution started to be implemented) having benefited from the measure. The Government is now considering whether to extend it, and if yes, whether it should be more targeted. Moreover, the 2013-2016 Youth Entrepreneurship and Employment Strategy includes measures to promote indefinite hiring, namely a reduced monthly contribution to the social security for the employers which establish a permanent employment contract with a beneficiary of the youth guarantee.

54. The new single job portal (www.empleate.gob.es) should support labour mobility in Spain. Geographical fragmentation of employment services has been one of the factors constraining labour mobility. Since July, for the first time all job offers from the public national and regional employment services and from the private sector which join the project have been available in one single portal. The portal provides a meeting point for the self-employed and potential investors, and facilitates access to information on contract regulations, hiring incentives and bureaucratic procedures. Ideally, the single job portal will be extended by compiling all job offers included in other web portals, public and private, which wish to join this initiative.([20]) The single job portal is also connected to the new Youth Guarantee portal, and will be also linked to initiatives from other Ministries, such as the web portal *Informate* (compiling information on education and training opportunities in Spain) or the web portal www.todofp.es from the Ministry of Education, Culture and Sport which provides a wide range of information regarding the whole education system in Spain.

55. The new active labour market policies (ALMPs) framework is established in the 2014-2016 Activation Strategy and the 2014 Annual Employment Plan, adopted in September 2014. The cornerstone of the new model is the result-oriented approach which determines priority setting and access to funds for the regions, charged with the implementation of ALMPs. The set of common objectives, monitoring indicators and quantified targets, concretised for this year in the 2014 Annual Employment Plan, will guide the measures carried out by public employment services (PES) at national and regional level. The new model aims at enhancing coordination amongst the regions, reinforcing effectiveness of policy actions and allowing for efficiency in fund allocation and decision making. Anticipating the strategy, the Royal Decree Law 8/2014 amended the Law on Employment already in July. The RDL foresees also some changes to the regulation of private recruitment and interim agencies to adapt them to the law on market unity.

56. The Activation Strategy also implies a new role for the PES, with a new definition of the common catalogue of employment services. The provision of individualised services is one of the structural objectives of the Strategy, and of the 2014 Annual Employment Plan. Indeed, the degree of progress towards this objective will be measured and taken into account for the allocation of funds to the regions in 2015. This responds to the idea that PES must increasingly play a role to respond to individual circumstances and offer personalised assistance to the job-seeker. Some steps have been taken already in this respect, namely the adoption of the general framework of public–private cooperation in intermediation and recruitment services. The common catalogue of employment services includes those services which must be common to all PES across the country, related to (i) professional guidance to the job-seeker, (ii) placement and advice to firms, (iii) training and qualification for employment, and (iv) support to self-employment and entrepreneurship. However, there remain significant challenges concerning PES tools and resources. In this respect, swift and effective implementation of the measures foreseen in the 2014-2016 Activation Strategy will be key to provide the adequate assistance, monitoring and evaluation.

57. The implementation of the Youth Guarantee (YG) and the 2013-2016 Youth Entrepreneurship and Employment Strategy is progressing. In particular, the national Youth Guarantee plan is in place since July 2014, regulated by Royal Decree-Law 8/2014. The purpose of the YG system is to tackle youth unemployment by ensuring that all young people aged between 16 and 25 (or 30 for people with disabilities) get a good quality, concrete offer of employment, apprenticeship, work placement or education within four months of them leaving formal education or become unemployed. The plan foresees the creation of a database of potential beneficiaries and an IT register, which already records data on 30,000 young people.([21]) Some concrete measures are in place (namely the "*training pills*", or short-duration training courses, in electronic format). The YG is built upon the 2013-2016 Youth Entrepreneurship and Employment Strategy, and has four immediate objectives to (i) improve intermediation, (ii) improve employability and skills, (iii) provide support for recruitment, and (iv) promote entrepreneurship. It will be partially financed by the European Social Fund interventions in Spain and the EU Youth Employment Initiative (up to EUR 1.9 bn).

58. To support youth employment, the Council of Ministers also established new temporary hiring incentives linked to the youth guarantee. The Royal Decree-Law (RDL) 8/2014 foresees

([20]) By second half of July, seven private job portals have joined Empléate: (1) Infoempleo, (2) Monster, (3) Tic Job, (4) Trabajando.com, (5) Universia, (6) FSC Inserta from Fundación ONCE and (7) Hazloposible.

([21]) According to the Ministry of Labour, 845 000 young people could potentially benefit from the Spanish YG.

that until 30 June 2016 employers can benefit from a reduction of EUR 300 in their social security contributions for signing permanent employment contracts with beneficiaries of the youth guarantee. The incentive is valid for six months and is compatible with any other permanent employment incentives already in place. The reduced contribution is conditional on the maintenance of the employment during at least six months and on net increase in indefinite employment.

59. The July legislative package (RDL 8/2014) also reinforces the incentives to the training and apprenticeship contracts. Firms with fewer than 250 employees can benefit from a 100% reduction in social security contributions on training contracts (75% reduction for companies with 250 or more workers). The current reduction in the contributions of 50% for the apprenticeship contracts is increased to 100% when the contract is signed with a beneficiary of the national YG system. Moreover, the RDL establishes new tax breaks for paid work undertaken by university students and participants of vocational training courses.

4.4. STRUCTURAL MEASURES TO PROMOTE GROWTH AND COMPETITIVENESS

60. The implementation of structural reforms in reponse to the CSRs has progressed further over the last six months, although the pace of implementation could be boosted. Recently adopted new initiatives include the easing of licencing requirements in retail and the reform of the gas system. The gradual implementation of the law on market unity continues, although at a slow pace. Some missing elements of the 2013 electricity system reform have been adopted. Other flagship measures have suffered delays, such as the parliamentary approval of the de-indexation law and, most prominently, the law on professional services and associations, which so far has not even been submitted to Parliament. The challenge is now to implement fully and in a timely manner the adopted reforms and to build on recent improvements. There are, notably, implementation lags and risks stemming from the need of joint delivery by various tiers of government.

61. The implementation of the law on market unity needs to be accelerated. The law aims at removing measures that may directly or indirectly obstruct the free movement of goods and services and the establishment of economic operators throughout Spain. All the articles of the law have now entered into force, the last ones on 11 September 2014.([22]) The law sets out a period of six months to amend provisions in sector-specific legislation that are in direct opposition with it. However, this deadline has not been met and various proposals for amendments (covering regional and central government legislation) were being processed at the time of writing. Prompt completion of these processes is essential to guarantee a smooth application of the law. In parallel, 25 sectorial conferences, bodies with central and regional government representatives working to adapt regulatory frameworks to principles of the law on market unity, have been convened.([23]) Technical groups on specific policy areas reporting to those have been created and tasked with the review of regional authorisation schemes and requirements for the exercise of economic activities. The findings and proposals of the working groups have to be discussed and agreed at the corresponding sectorial conferences and then, be legislated by the central and regional governments. However, with regional legislatures soon coming to an end and lengthy decision-making processes, the outcome of these conferences remains most uncertain.

62. In spite of recent progress, more needs to be done to ease business start-ups and reduce administrative burdens in Spain. Spain is gradually implementing the public administration

([22]) These refer to the provisions on effectiveness of administrative actions throughout Spanish territory (Art. 20); integration of information maintained in sectorial registries (Art. 21) and to the competent authority for the supervision of operators (Art. 21). The first provision guarantee the effectiveness of administrative actions of a competent authority which permit access to an economic activity or its performance throughout Spanish territory, so that economic operators do not need to undergo any additional procedure or meet new requirements set out elsewhere. It is combined with rules deciding on which licensing authority (i.e., the authority of origin or destination of the economic operator) has the power to supervise the access to and exercise of economic activities. Note that the principle of effectiveness throughout Spanish territory will not be applied in the case of authorisations, sworn declarations and statements linked to a specific installation or item of infrastructure.

([23]) To note: the mandate of the sectorial conferences is different from the above-mentioned amendments to sector specific legislation.

reform, which sets a goal of reducing administrative burdens. The September 2013 entrepreneurship law aimed among other things to simplify procedures for company creation and to reduce administrative burdens. To that end, the law created new company forms([24]) and reduced time and number of procedures needed to start up a private limited liability company. The changes have helped to improve Spain's position in international rankings on company creation. The 2015 edition of the World Bank's Doing Business publication ranks Spain at 74th position in the ease of starting up a company (vs. 115th position in the 2014 edition). Despite considerable progress, this is still lower than countries sharing similar legal systems. Moreover, the one-in one-out principle for administrative burden reduction set out in the entrepreneurship law has not been implemented to date. Delays in the approval of legislation setting out the details are preventing the application of this principle.

63. Spain's research and innovation (R&I) system needs more resources and stronger governance. The 2015 central government's draft budget foresees an increase in public spending on R&I by 4.8%. The 2013 entrepreneurship law also set out fiscal incentives for R&D and business angels. However, the authorities found it was early to assess the ability of this reform to increase private R&D spending and raise seed capital, as data coming from the 2013 (and 2014) tax declarations was not yet available. While Spain's research and innovation system needs increased financial and human resources, these would also have to be accompanied by structural reforms ensuring a more effective and efficient use of those. A recent review of Spain's research and innovation system([25]) revealed that its functioning has been inhibited by factors including fragmentation in governance, institutional rigidities and lack of an effective system of evaluation at policy or institution levels. To that end, the review issued a series of recommendations, including the creation of the central government's research agency which would be tasked with implementation of the reform programme. The recommendations concern both the central and regional governments.

64. The July 2014 retail reform aims to facilitate opening or expanding retail trade establishments.([26]) In addition to capping the fees charged on use of credit and debit cards, the reform increased by ten the number of cities with designated areas of total freedom of opening hours for all types of retail establishments (the so-called areas of large touristic turnout). Moreover, it eased licencing requirements by further limiting the number of instances where public bodies can condition the establishment, sale and expansion of retail outlet to the granting of a permit and halving the length of the licensing procedure. The amendments go in the right direction. Looking forward, attention should be paid to potential restrictions on retail trade activities originating from urban planning rules, whose elimination would require a separate legal intervention.

65. The submission to parliament of the reform of professional services keeps being delayed. The draft law needs to be submitted to parliament soon if it is to have a chance of being approved before the end of the legislature. At the same time, it is important to keep the level of ambition of this reform, by (i) limiting the number of professions with mandatory membership to cases where this is justified and proportionate, (ii) ensuring that registration and membership fees to those professional associations do not create barriers to competition, (iii) increasing the transparency and accountability of professional associations *vis-a-vis* consumers of professional services as well as its own members and (iv) ensuring market unity in the access to and exercise of professional services.

66. The law on dis-indexation had not been adopted as of end-October 2014. The draft law was submitted to the Parliament in late December 2013, and aims to discontinue current indexation schemes on fees, administered prices and public sector contracts.([27]) To that end, it forbids automatic and periodic updates of prices based on general price indices. However, it permits periodic

([24]) According to the Spanish Companies' Registry, 136 gradually-incorporated private limited liability companies and 51 limited liability entrepreneurs were created up until June 2014.

([25]) The report can be found at http://www.mineco.gob.es/stfls/MICINN/Prensa/FICHEROS/2014/140801_final_report_public_version.pdf

([26]) Royal Decree-Law 8/2014.

([27]) Indexation schemes on collective bargaining, financial sector instruments and pensions are excluded from the scope of this reform, as some of them have their own dedicated legal instrument (e.g. on pensions).

and non-periodic updates of those values on an exceptional basis, based on the evolution of specific costs. The draft law also provides for new indexation mechanisms to be applied on a voluntary basis on privately agreed prices, such as on housing rents, yielding lower price increases than indexation based on the consumer price index. The law however needs to be complemented with secondary legislation, to set out the details on periodic and non-periodic indexation.

67. The 2013 reform of the electricity sector helped to contain the tariff deficit, and the 2014 deficit should be considerably smaller or the system should be in balance. The 'electricity tariff deficit' (i.e. the gap between regulated 'access tariffs' paid by consumers and various regulated costs – including distribution costs and subsidies for renewable energy production) reached EUR 3.2-3.4 billion in 2013, and the accumulated tariff debt amounted to EUR 28.5 bn at the end of 2013, almost 3% of GDP. The increase in access tariffs and the reduction in various costs of the electricity system applied with the 2013 reform help to balance the system in 2014. The authorities consider that the measures taken up to date should be sufficient to close the deficit structurally.

68. In June 2014, the authorities adopted a new remuneration scheme of renewable energy sources, a major remaining element of the 2013 electricity reform. While the new remuneration scheme has been in force from July 2013 (the date of entry of the Royal Decree-Law 9/2013), the operators of renewable energy know from June 2014 which remuneration standards are applied to their particular installations, and what remuneration they can expect.

69. In July 2014, the government adopted a reform to prevent gas price increases for consumers and to reduce a potential liability for public finances stemming from the gas tariff deficit. Weak demand for gas and the need to maintain an extensive gas network have recently pushed up the gas tariff deficit (i.e. the gap between the network access tariffs paid by consumers and the regulated costs of the gas system). According to the energy regulator (CNMC), the accumulated deficit was equal to EUR 326 million in 2013, and would have reached EUR 800 million by the end of 2014, if no action had been taken.([28]) The Royal Decree-Law 8/2014 proposed that at the end of 2014 the accumulated deficit will be recognised as debt of the system and gas companies will recover it from customers in the next 15 years, with annuities appearing in the system's costs. Looking forward, the law intends to halt the increase in the debt by revising downwards the remuneration of regulated activities (system's costs), and by introducing the principle of system's sufficiency. According to the energy regulator, the overall yearly savings of the law could amount to EUR 230 million.

70. The authorities are taking some steps to use the stock of transport infrastructure more efficiently. First, the gradual process of opening railway passenger services to competition has been launched, but the effects in terms of better use of the extensive infrastructure stock still have to be seen. From 2015, a licenced provider will be able to compete with the incumbent operator *Renfe Operadora* on the network between Madrid, Valencia, Alicante and Murcia. After seven years of validity of the licence, the corridor will be fully opened to competition. For the moment there is no official schedule to open other parts of the network with a significant passenger potential. Second, in July 2014, the formation of a fund to improve land accessibility of seaports was announced. The fund, based on obligatory contributions of port authorities, is to improve land accessibility of ports by road and rail. The regulatory framework of the fund still needs to be developed. Besides, the maximum length of port concessions will be extended from 35 to 50 years to promote investments in ports.

71. The effectiveness of the mechanisms to limit potential liabilities for public finances stemming from transport infrastructure is uncertain. Following the creation of an Observatory of Transport and Logistics, as a tool for a more efficient diagnosis, the government has started to set up an advisory council on future infrastructure projects, but it is doubtful whether the council will be independent, as requested by the country-specific recommendations in 2013 and 2014. In July 2014,([29]) the government announced that a 49% stake in AENA, the operator of the network of 46 airports and two heliports, would be

([28]) Data provided by the CNMC.
([29]) Royal Decree-Law 8/2014.

sold to private investors. In particular, 21% of shares have been offered to strategic investors and at least 28% will be placed in the stock exchange. In October, the privatisation plans were postponed until 2015. In mid-October, the government presented an official proposal to bail out the insolvent motorways in concession, thus requiring the negotiating parties to reach an agreement, which should be subsequently approved in court.

ANNEX A

Main economic and financial indicators

Table Annex A.1: **Main economic and financial indicators**

	1995 -1999	2000 -2004	2005 -2008	2009	2010	2011	2012	2013	2014 (e)	2015 (f)
Core indicators										
GDP growth rate	3.6	3.7	3.2	- 3.6	0.0	- 0.6	- 2.1	- 1.2	1.2	1.7
Private consumption (annual % change)	3.3	3.5	2.6	- 3.6	0.3	- 2.0	- 2.9	- 2.3	2.0	2.0
Public consumption (annual % change)	2.7	4.7	5.7	4.1	1.5	- 0.3	- 3.7	- 2.9	0.4	- 1.4
HICP (annual % change)	2.8	3.2	3.5	- 0.2	2.0	3.1	2.4	1.5	- 0.1	0.5
Domestic demand incl. stocks	4.1	4.3	3.7	- 6.4	- 0.5	- 2.7	- 4.3	- 2.7	1.4	1.6
Unemployment rate (% of labour force)	17.8	11.3	9.3	17.9	19.9	21.4	24.8	26.1	24.8	23.5
Gross fixed capital formation (% of GDP)	22.9	27.0	30.3	24.3	23.0	21.4	19.7	18.5	18.5	19.0
Gross national saving (% of GDP)	21.9	23.0	21.7	20.3	19.7	18.7	19.8	20.4	19.4	20.1
General Government (% of GDP)										
Balance (g)	- 4.1	- 0.5	0.2	- 11.0	- 9.4	- 9.4	- 10.3	- 6.8	- 5.6	- 4.6
Gross debt	63.0	51.3	39.0	52.7	60.1	69.2	84.4	92.1	98.1	101.2
Interest expenditure	4.4	2.6	1.6	1.7	1.9	2.4	2.9	3.3	3.3	3.4
Households										
Households saving rate	13.0	10.3	8.7	15.1	13.4	11.7	9.0	11.2	10.4	10.5
Rest of the world (% of GDP)										
Trade balance	- 0.7	- 2.7	- 5.5	- 1.2	- 1.3	- 0.2	1.6	3.4	3.0	3.2
Trade balance, goods	- 3.2	- 5.5	- 7.9	- 3.9	- 4.5	- 4.1	- 2.4	- 1.1	- 0.6	- 0.4
Trade balance, services	2.6	2.9	2.4	2.7	3.2	3.8	4.0	4.5	3.6	3.6
Current account balance	- 1.3	- 4.3	- 8.9	- 4.3	- 3.9	- 3.3	- 0.4	1.5	0.5	0.7
Net financial assets (i)	- 26.2	- 38.7	- 68.4	- 89.1	- 84.2	- 85.4	- 87.9	- 95.6	- 97.1	n.a.
Net international investment position (i)	- 26.9	- 41.3	- 69.7	- 93.8	- 89.1	- 91.4	- 92.8	- 98.2	- 99.7	n.a.
Competitiveness (index, 2005=100)										
Real effective exchange rate relative to the rest of the euro area	90.8	95.3	104.2	105.1	103.9	102.1	97.0	95.0	93.9	93.4
Real effective exchange rate relative to the rest of the European Union	93.3	94.9	103.8	108.0	105.5	103.9	98.1	96.7	95.2	94.4
Real effective exchange rate relative to the rest of 37 industrialised countries	91.6	92.2	104.7	109.4	105.2	103.8	97.0	97.1	96.3	94.6
Banking sector										
Assets (% of GDP) (i)	173.7	194.9	274.5	329.2	332.0	346.1	347.9	308.1	300.4	n.a.
Private domestic credit (y-o-y %)	11.8	14.7	18.9	- 1.6	0.8	- 3.2	- 9.9	- 10.2	- 8.3	n.a.
Non-performing loans (NPLs), total	3.3	1.1	1.5	5.1	5.8	7.8	10.4	13.6	13.2	n.a.
NPLs, productive activities	n.a.	1.2	1.5	6.2	7.9	11.3	15.5	20.3	19.4	n.a.
" of which, construction, and	n.a.	1.0	1.7	8.5	12.1	18.2	25.8	34.3	32.5	n.a.
" real estate activities	n.a.	0.6	1.8	10.1	14.0	21.4	29.1	38.0	38.0	n.a.
NPLs, residential mortgages	n.a.	0.4	1.0	2.9	2.6	3.1	4.3	6.4	n.a.	n.a.
Tier 1 ratio (%)	n.a.	n.a.	n.a.	9.3	9.6	10.2	9.7	11.7	n.a.	n.a.
Interest rates										
10 year spread vis-à-vis the Bund	1.6	0.2	0.1	0.8	1.5	2.8	4.3	3.0	1.6	n.a.
CDS 5 year	n.a.	n.a.	14.6	92.0	204.0	319.6	431.9	235.4	91.3	n.a.

(e) 2014: estimates or latest available data
(f) 2015: forecast
(g) General government balances include capital transfers related to support of banks
(i) ESA95
Source: Ameco, BdE, Eurostat, IHS Global Insight

ANNEX B

State of play with MIP relevant recommendations

Main components of CSR	Measures announced in NRP	Ddl NRP	Progress
1. Measures to improve the quality of public expenditure and taxation and the efficiency of public administration			
[CSR 1] Ensure that the new independent fiscal authority becomes fully operational as soon as possible.		The NRP announces that the independent fiscal authority will be operational in 2014.	On 14/11/2013 the independent fiscal authority (AIReF) was created by Organic Law 6/2014. On 28/03/2014 statutes of AIReF were adopted by Royal Decree 215/2014. On 24/01/2014 the president was appointed. In July 2014, AIReF published two opinions on changes to the budgetary cycle procedures and on debt sustainability. It also published a report on six regions' economic and financial plans. On 11/09/2014, AIReF was staffed with 24 additional positions. The fiscal authority has therefore one president, three directors and 24 staff, of which five are administrative assistants. On 26/09/2014, AIReF published a report endorsing the government's macroeconomic forecasts for the 2015 budget. On 15/10/2014, AIReF published a report on the 2015 draft budgetary plan. AIReF is now operational. Secondary legislation securing access to the information AIReF needs to carry out its duties was being prepared at the time of writing.
[CSR 1] Ensure a full implementation of the preventive, corrective and enforcement measures in the Budgetary Stability Organic Law at all levels of government, including on the elimination of public sector commercial arrears.	The NRP informs on the application of provisions of the Budgetary Stability Organic Law (BSOL) to date.		Despite considerable deterioration in regional public finances, the central government has not activated any preventive measures set out in BSOL. In addition, the approval of corrective measures (namely regional economic and financial plans) has gone at a much slower pace than in 2013. Only one economic and financial plan had been approved by the Financial and Fiscal Policy Council, while five others were pending at the time of writing. The provisions on late payments of BSOL will

			start being enforced once public sector bodies start publishing their average payment periods according to a common methodology in late October 2014. This comes more than ten months after the law on late payments was passed in Parliament. The central government has also eased financing conditions for regions having adhered to liquidity enhancing mechanisms such as the regional liquidity fund.
[CSR 1] Carry out by February 2015 a systematic review of expenditure at all levels of government to underpin the efficiency and quality of public spending going forward.			The public administration reform measures (see CSR #8 below) follow a review of spending categories across various government levels. Additional proposals to increase efficiency of regional spending on healthcare, education and social matters were scheduled for discussion at the 31/07/2014 Financial and Fiscal Policy Council. However, at the cut-off date of this report, no new efficiency-enhancing measures in the above-mentioned areas had been agreed by the Financial and Fiscal Policy Council.
[CSR 1] Continue to increase the cost-effectiveness of the healthcare sector, in particular by further rationalising pharmaceutical spending, including in hospitals and strengthening coordination across types of care, while maintaining accessibility for vulnerable groups.	The NRP lists measures which have been adopted to increase the cost-effectiveness of the healthcare sector.		On 24/10/2014, the Council of Ministers gave an authorisation to adopt a framework agreement for centralised purchasing of pharmaceutical products.
[CSR 1] Adopt by the end of 2014 a comprehensive tax reform to make the tax system simpler and more conducive to growth and job creation, preservation of the environment and stability of revenues.	The NRP announced that the tax reform is supposed to: (i) modernise the tax system in accordance with international best practices; (ii) ensure sufficient tax income and increasing revenue collection by paying special attention to thin fiscal bases and to tax fraud, but without discouraging job creation; (iii) contribute to fiscal consolidation and job creation, and (iv) favour economic development,	The reform is to be adopted in the second half of 2014.	On 1/08/2014, the Council of Ministers approved the proposal of tax reform which is to be adopted by the Parliament by the end of 2014.

	ensure market unity and fiscal neutrality and enhance the competitiveness of the Spanish economy.		
[CSR 8] Implement at all government levels the recommendations of the committee for the reform of the public administration.	The NRP announced three flagship initiatives for 2014: (i) the new law on the common administrative procedure, (ii) the reform of the law of public grants and (iii) amendments to the law on Spain's civil service, to cater for proper human resource planning, training and evaluation of performance. These initiatives come on top of other planned measures to remove duplicated administrative structures, reduce overheads and simplify administrative burdens. Last, the NRP refers to the entry into operations of the Ministry of Finance's economic and financial database, which will gather all economic and fiscal data from the three levels of general government.		On 16/09/2014, the Law 15/2014 on rationalisation of public sector and other measures in the area of reform of public administration was adopted by the Parliament. On 19/09/2014, the Council of Ministers examined the first CORA annual report, which describes progress in the public administration reform in the last 12 months. On 19/09/2014, two manuals on the public administration reform were presented to the government, on (i) administrative simplification and reduction of administrative burden for the State, and (ii) rationalisation and elimination of duplications. As of June 2014, 101 out of 212 public administration reform measures were implemented (45.5% of the total number of measures). Only 4 measures are at an initial stage.
[CSR 8] Strengthen control mechanisms and increase the transparency of administrative decisions, in particular at regional and local levels.			On 9/12/2013 the law 19/2013 on transparency, public access to information and good governance was adopted. Certain provisions of the law will only enter into force in December 2014 and local and regional bodies will have to comply with the new obligations until December 2015. On 22/02/2014 the draft organic law on the control of political parties' economic and financial activities was submitted to Parliament. This draft law amends organic law 8/2007 on political party's financing, organic law 6/2002 on political parties and organic law 2/1982 on the Court of Auditors. On 22/02/2014 the law on the exercise of duties of senior officials in Spain's central administration was submitted to Parliament.
[CSR 8] Complete and monitor closely	The NRP lists measures adopted in		The Ministry of Labour periodically publishes data on the

the ongoing measures to fight against the shadow economy and undeclared work.	2012 and 2013 to reduce undeclared work and tax avoidance.		controls performed to fight undeclared work. On 1/08/2014 the Council of Ministers approved the proposal of tax reform which is to be adopted by the Parliament by the end of 2014 that includes fighting against tax fraud.
[CSR 8] Adopt pending reforms on the structure of the judiciary and on the judicial map and ensure implementation of adopted reforms.	The NRP announces that first instance courts will be replaced by provincial courts (*Ley Orgánica del Poder Judicial* and *Ley de Demarcación y Planta Judicial*). Moreover, to reduce burden on judges, in cases where there is no controversy, clerks could assume responsibilities originally borne by judges (*Ley de Jurisdicción Voluntaria*). Finally, the reform intends to improve efficiency of the system by (i) proposing that a panel of three judges, instead of a single judge, oversees major cases, (ii) quarterly publication of binding jurisprudence by the Supreme Court, and (iii) changes in the judicial career.		On 2/08/2014 the draft law on voluntary jurisdiction was sent to the Parliament.
2. Measures to make the financial sector stable and make sure that deleveraging of the private sector goes smoothly			
[CSR 2] Complete the reform of the saving banks sector, as regards the adoption of secondary legislation and complete the restructuring of state-owned savings banks in order to accelerate their full recovery and facilitate their return to private ownership.			Discussion on the first draft of the act implementing the savings banks law started in October 2014.
[CSR 2] Promote banks' efforts to sustain strong capital ratios.			Solvency of banks has been further strengthened.
[CSR 2] Monitor the asset management company SAREB's activity in order to ensure timely asset disposal while			SAREB continues divesting its assets at a moderate pace, concentrated in key areas, such as Barcelona, Madrid, Malaga and Alicante.

minimising the cost to the taxpayer.			
[CSR 2] Complete the ongoing measures to widen SMEs access to finance, in particular by finalising the ongoing measures to improve non-bank financial intermediation.	To foster new bank lending, the NRP announced that ICO (state-owned bank and finance agency) should expand further its lending facilities to Spanish banks, including financing of export activities. The NRP also announced a draft law on promoting corporate financing which has a double objective of improving access to bank credit and developing non-bank financial intermediation.		On 6/06/2014 the Council of Ministers adopted the plan for growth, competitiveness and efficiency. The plan includes measures to boost ICO's credit lines in 2014 and to improve SMEs' access to finance by strengthening bank guarantees managed by ICO. On 4/07/2014 a Royal Decree which sets out the regulation of the so-called internationalisation bonds was adopted. On 4/07/2014 the Council of Ministers adopted a draft law regulating venture capital companies and closed-end collective investment schemes. The draft has been submitted to the Parliament in an emergency procedure. On 03/10/2014, the Council of Ministers adopted a draft law on promoting corporate financing.
[CSR 2] Remove remaining bottlenecks in the corporate insolvency framework, in particular by enhancing the expertise of insolvency administrators and the capacity of the judicial system to handle insolvency cases, and develop a permanent framework for personal insolvency, paying due attention to balanced creditor/borrower rights and financial stability considerations.			On 5/09/2014, the Council of Ministers adopted the RDL 11/2014 on urgent measures in the area of insolvency. The RDL revises the in-court debt restructuring procedures, and promotes sales of the liquidated businesses as a going concern. On 30/09/2014 the Parliament amended the RDL 4/2014 revising pre-insolvency proceedings, enhancing the insolvency administrators' regime and adopted it as the Law 17/2014.
3. Measures to improve the functioning of the labour market and enhance human capital			
[CSR 3] Pursue new measures to reduce labour market segmentation to favour sustainable, quality jobs, for instance through reducing the number of contract types and ensuring a balanced access to severance rights.			The Government introduced a temporary reduced form of employers' contribution to social security for net indefinite employment in February 2014, which will expire in December.
[CSR 3] Continue regular monitoring of the labour market reforms.	The NRP focuses on the description of the already adopted measures (i.e. part-time strategy, new flat rate social security contribution to create net		The Government regularly publishes data on employment, unemployment and activity, evolution of contracts and hiring trends (including on the use of hiring subsidies),

	indefinite employment), and in the description of the comprehensive reform of active labour market policies.		dismissal procedures and collective bargaining.
[CSR 3] Promote real wage developments consistent with the objective of creating jobs.			The social partners' *Interconfederal Agreement for Employment and Collective Negotiation 2012-2014* (valid until end-year) linked wages to productivity growth, and included guidelines for wage bargaining in 2012, 2013, and 2014. The social partners are currently discussing a new agreement.
[CSR 3] Strengthen the job-search requirement in unemployment benefits.			On 5/09/2014, the Council of Ministers adopted the 2014-2016 Activation Strategy, which establishes the new multiannual tool to frame the work of the different public employment services (national and regional), with common objectives and actions. The strategy intends, among other objectives, to reinforce the links between active and passive labour market policies, by enhancing activation of unemployed perceiving an unemployment benefits.
[CSR 3] Enhance the effectiveness and targeting of active labour market policies, including hiring subsidies, particularly for those facing more difficulties in accessing employment.			On 4/07/2014, the Council of Ministers adopted a RDL 8/2014 on urgent measures to reinforce growth, competitiveness and efficiency (validated by the Parliament on 10/07/2014), which, among others, modifies the Law 53/2006 of 16 December, on Employment, to adapt it to the new active labour market policies (ALMPs) model, set out in the 2014-2016 Spanish Activation Strategy. On 5/09/2014, the Government adopted the 2014-2016 Activation Strategy. The Strategy intends to improve targeting of ALMPs and in consequence the employability of groups particularly affected by unemployment: workers over 55, long-term unemployed and beneficiaries of the PREPARA programme. The Strategy is accompanied by a regulation on employment programmes and should lead to

			a results-based reallocation of funds.
[CSR 3] Reinforce the coordination between labour market and education and training policies.			On 5/09/2014, the Government adopted the 2014-2016 Activation Strategy. The Strategy intends to improve the employability of young people and promoting entrepreneurship, to improve the quality of vocational training for employment. The Strategy is accompanied by a regulation on vocational training for workers. Regarding the education and training system the implementation of the new basic vocational education and training, together with the broadening of dual vocational training is expected to contribute to improve employability and strengthen the links with the labour market. Preparations of the reform of the training system for the employed are quite advanced. The reform, guided by the principles of transparency and competition in the provision of training, will be adopted shortly.
[CSR 3] Accelerate the modernisation of public employment services to ensure effective personalised counselling, adequate training and job-matching, with special focus on the long-term unemployed.	The NRP refers to the new occupational training system and the establishment of a new, common catalogue of employment services (applicable to all, national and regional, employment services).	Reform of the occupational training system to be finalised in 2014.	On 5/09/2014, the Government adopted the 2014-2016 Activation Strategy. The Strategy is complemented by a mutual learning and best practices exchange programme among Public Employment Services, and the regulation of a common catalogue of employment services, as the minimum to be provided by all employment services in Spain.
[CSR 3] Ensure the effective application of public-private cooperation in placement services before the end of 2014, and monitor the quality of services provided.			The framework agreement on public-private cooperation in recruitment services was set in June 2014. On 4/07/2014, the Council of Ministers adopted a RDL 8/2014 on urgent measures to reinforce growth, competitiveness and efficiency (validated by the Parliament on 10/07/2014), which foresees some changes to the regulation of private recruitment and interim

			agencies to adapt them to the Law on Market Unity.
[CSR 3] Ensure the effective functioning of the Single Job Portal and combine it with further measures to support labour mobility.			On 17/07/2014, the Minister of Labour presented the new *Portal de Empleo y Autoempleo*, called Empléate (www.empleate.gob.es)
[CSR 4] Implement the 2013-2016 Youth Entrepreneurship and Employment Strategy and evaluate its effectiveness.			On 4/07/2014, the Council of Ministers adopted a RDL 8/2014 on urgent measures to reinforce growth, competitiveness and efficiency (validated by the Parliament on 10/07/2014), which foresees the national youth guarantee system. By 10/09/2014 about 33,000 persons had registered in the system – either through the e-portal set up in early July, or directly. According to the Ministry of Employment and Social Affairs, about 15,000 of these applications have been considered positively on the basis of the established criteria and about 6,700 have already been approved. Evaluation of the Youth Entrepreneurship and employment Strategy is still foreseen for the end of 2014.
[CSR 4] Provide good quality offers of employment, apprenticeships and traineeships for young people and improve the outreach to non-registered unemployed young people, in line with the objectives of a youth guarantee.			On 4/07/2014, the Council of Ministers adopted a series of legislative measures (via RDL 8/2014) covering the implementation of the national youth guarantee plan (validated by the Parliament on 10/07/2014). The RDL 8/2014 established a new temporary hiring incentive, linked to the youth guarantee. The RDL foresees a temporary reduction of EUR 300 in the employers' social security contributions, over six months, for the permanent employment of those who benefit from the youth guarantee. The incentive will remain in force until 30/06/2016. The RDL 8/2014 reinforced incentives to the training and apprenticeship contracts by allowing higher reductions in social security contributions. Moreover, new tax breaks are

			established for paid work experience undertaken by university students and those on vocational training courses.
[CSR 4] Effectively implement the new educational schemes to increase the quality of primary and secondary education.	The NRP describes the progress on implementation of the dual vocational training, but there are no announcements of further measures to promote vocational education and training.		The Law on Quality of Education (LOMCE) is being implemented gradually, starting from the school year 2014/2015. The complex implementation process requires dialogue with regions.
[CSR 4] Enhance guidance and support for groups at risk of early school leaving.	The NRP draws on the implementation of the Law on Quality of Education (LOMCE) to improve education performance and combat early leaving from school and training. The law was adopted in November 2013.		The Law on Quality of Education (LOMCE) is being implemented gradually, starting from the school year 2014/2015. The complex implementation process requires dialogue with regions.
[CSR 4] Increase the labour-market relevance of vocational education and training and of higher education, in particular by enhancing the cooperation with employers and supporting the training of trainers and tutors.	The NRP describes the progress on implementation of the dual vocational training, but there are no announcements of further measures to promote vocational education and training.		The Law on Quality of Education (LOMCE) is being implemented as foreseen, gradually, starting from the school year 2014/2015. Linked to the youth guarantee system, in place since July 2014, a specific committee has been set up in the labour market sectorial conference, which will examine, among others, the relevance of education and training curricula to the labour market needs. The implementation of the pilot projects on dual vocational training continues (currently developed in 1,000 firms and benefiting 20,000 pupils), and its extension to other sectors and companies is already foreseen (including also by amending the 2012 RDL establishing the bases for dual vocational training in Spain).
4. Structural measures promoting growth and competitiveness			
[CSR 6] Ensure an ambitious and swift implementation of Law 20/2013 on Market Unity at all levels of administration.	The NRP gives more detail on secondary legislation needed to implement the Law on Market Unity. It describes the planned changes to sector specific legislation in areas such as		As of end September 2014, 25 sectorial conferences have been convened and 30 technical groups on specific policy matters have been created. Work is relatively more advanced in the following four areas: retail, gambling, tourism and social services.

	railways, gambling, funeral services, social services, retail trade, urban planning, environment, industrial licensing, waste management, education services, temporary employment agencies, health and veterinary services, hunting and fishing and consumer protection.		
[CSR 6] Adopt an ambitious reform of professional services and of professional associations by the end of 2014, defining the professions requiring registration in a professional organisation, and the transparency and accountability of professional bodies, opening up unjustifiably reserved activities and safeguarding market unity in the access to and exercise of professional services in Spain.			No progress
[CSR 6] Further reduce the time, cost and number of procedures required for setting up an operating business.	As far as the Law on Entrepreneurship adopted in 2013 is concerned, the NRP announced the issuance of company model statutes (to speed up the creation of private limited companies) and the publication of regulatory indicators at regional level (Doing Business project at regional level in cooperation with the World Bank), to help assess business climate in Spain's regions. The NRP refers to the regional transposition of the law on environmental assessment, adopted in December 2013, which is expected to speed up licensing for environmental programmes, plans and projects. Moreover, the NRP announced the plan to enforce the observance of		Several provisions of the entrepreneurship law aim to reduce the time, cost and number of procedures to set up a private limited liability company (SRL) in Spain.

	administrative deadlines across all government levels, which is supposed to benefit firms.		
[CSR 6] Address unjustified restrictions to the establishment of large-scale retail premises, in particular through a revision of existing regional planning regulations.	The NRP announces that cooperation on retail reform between central and regional authorities is conducted in the framework of the Law on Market Unity.		On 4/07/2014, the Council of Ministers adopted a RDL 8/2014 amending Art. 6 of the Spanish law on retail trade (i.e., law 7/1996). Among others, the amendments limit the number of cases where licensing authorities can subject the establishment, sale and expansion of a retail outlet to the holding of a permit, shortens deadlines for the granting of licences and provides for the principle of tacit approval, should the relevant administration fail to reply within the statutory deadlines.
[CSR 6] Identify sources of financing for the new national strategy for science, technology and innovation and make operational the new State Research Agency.			On 6/06/2014, the Council of Ministers adopted a plan to improve growth, competitiveness and efficiency (passed as RDL 8/2014). On R&I, the plan includes: (i) a series of financial instruments managed by ICO (such as ICO's 2013-2015 technological fund, ICO risk capital funds); (ii) funding by CDTI (*Centro para el desarrollo tecnologico industrial*) of public–private cooperation projects on industrial research in strategic sectors; (iii) CDTI's collateral fund, to give guarantees to SME-led R&I projects, which will trigger EUR 1.14 billion of loans between 2014 and 2020; (iv) a global innovation credit line to assist SMEs purchase of high technology assets; and (v) implementation of the 2014 central government R&I plan, activating EUR 3 billion of public and private R&I investment over 2014-18. The 2015 central government's draft budget law increases public spending on R&I by 4.8%. The new State Research Agency has not been set up to date.
[CSR 7] Following the reform of 2013, ensure the effective elimination of deficit in the electricity system as of 2014, including by taking further structural measures if needed.	The NRP announced that the regulatory framework of the 2013 reform tackling the electricity tariff deficit will be further developed.		On 6/06/2014 the government adopted a new remuneration system for renewable power plants, limiting their earnings. This is one of the major implementation measures of the 2013 reform (RDL 9/2013 and Law 24/2013) aiming to reduce the deficit in the electricity system. On 4/07/2014, the Council of Ministers adopted RDL

			8/2014 to tackle the increasing gas tariff deficit. In particular, the RDL (i) introduced the principle of system's sufficiency and (ii) revised the remuneration of gas storage, transport and distribution activities.
[CSR 7] Address the problem of insolvent toll motorways so as to minimise costs for the State.			In March 2014, the authorities proposed to set up a public company taking over the motorways and presented a restructuring plan to the creditors. On 17/10/2014, the authorities initiated the insolvency procedure by presenting an official proposal to bail out the motorways, requiring the negotiating parties to reach an agreement, which should be subsequently approved in court.
[CSR 7] Set up an independent body to contribute to the assessment of future major infrastructure projects by the end of 2014.	The NRP informs that an advisory council on infrastructure projects will be set up.		On 30/06/2014, a Ministerial Order was adopted to set up an advisory council on infrastructure projects. The council will have up to 20 members coming from academia and stakeholders. Reports from the council will be based on data coming from the Ministry, and will not be binding.
[CSR 7] Take measures to ensure effective competition in freight and passenger rail services.	The NRP announced a gradual liberalisation of passenger rail services.	Liberalisation of passenger rail services to be gradually deployed over 2014.	On 13/06/2014, the Council of Ministers announced that a licence will be provided to compete with the incumbent *Renfe* on the network between Madrid, Valencia, Alicante, Murcia, and Castellón. The licence should become operational in 2015. After seven years of validity of the licence, the corridor will be fully opened to competition. On 4/07/2014, the Council of Ministers adopted RDL 8/2014, creating a fund to improve land accessibility of seaports. A regulatory framework of the fund needs to be developed.

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