Creditreform Sovereign Rating

Creditreform Rating

Rating Object	Rating Information	
KINGDOM OF SPAIN Long-term sovereign rating Foreign currency senior unsecured long-term debt Local currency senior unsecured long-term debt	Assigned Ratings/Outlook: **A- /stable**	Type: Monitoring, Unsolicited with participation
	Initial Rating Publication Date: Rating Renewal: Rating Methodologies:	30-09-2016 16-06-2023 "Sovereign Ratings" "Rating Criteria and Definitions"

Rating Action

Neuss, 16 June 2023

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

Contents

Key Rating Drivers

1. Large, prosperous and competitive economy benefiting from the strong post-pandemic rebound of tourism, alongside increases in other service export categories and further progress regarding the tackling of some structural deficiencies on the labor market; we expect economic growth to remain robust and real GDP to catch up with its pre-pandemic level in the course of the year, while the annual growth rate should moderate somewhat in 2024 due to increasingly dampening effects of monetary policy tightening

2. Spain's being the frontrunner in terms of disbursements of funds linked to the EU's Recovery and Resilience Facility (RRF) pays testament to significant progress in rolling out the reforms and initiatives set out in the Recovery, Transformation and Resilience Plan (RTRP), expected to markedly strengthen underlying growth and further enhance economic resilience over the medium term

3. Very strong institutional framework including significant advantages linked to EU/EMU membership; following significant losses for the left-leaning parties currently forming the minority government in the regional and municipal elections this May, parliamentary elections were brought forward to July 2023; despite a possible change of government, as suggested by latest polls, we expect commitment to further timely RTRP implementation and the green and digital transition to remain pronounced

4. Although retreating following the pandemic-induced leap, Spain's debt-to-GDP ratio remains among the highest in the EU; while subject to considerable uncertainty in the current geopolitical and domestic political context, we generally expect to see further improvement of fiscal metrics over the medium term, with the overall benign structure of the debt portfolio remaining an important mitigating factor regarding fiscal sustainability risks; we expect structural drivers amid advancing RTRP measures and reforms to have a positive impact on revenue

5. External risks continue to weigh on Spain's credit rating to some extent, but despite challenging circumstances, current account surpluses have persisted, contributing to further improvements of the still large, negative net international investment position

Reasons for the Rating Decision and Latest Developments[1]

Macroeconomic Performance

Spain's credit rating is underpinned by an overall favorable macroeconomic profile which includes the large size and wealth of the Spanish economy, as well as a good degree of competitiveness. Despite headwinds, GDP growth remained robust throughout 2022, partly bolstered by a strong recovery in tourism and sizeable expansion of other service exports. While still weighing somewhat on our assessment of Spain's macro profile, structural challenges on the labor market continue to be addressed by initiatives, e.g., to further reduce temporary employment. With direct dependency on Russian gas limited, and with energy prices having receded, there still remain some vulnerabilities related to the high weight of energy in Spain's HICP and to dampening effects from the negative reverberations of the war in Ukraine on important trading partners. Further advancements in terms of implementation of the Recovery, Transformation and Resilience Plan (RTRP) have made Spain a frontrunner as far as disbursement of funds linked to the Recovery and Resilience Facility (RRF) is concerned, strengthening the Spanish macroeconomic backdrop for its medium-term growth outlook. Progressing plans to enhance investment via RRF funding in a broad range of fields ranging from the agricultural to the digital space add to constructive prospects as regards medium-term economic developments.

Spain's economy continued to expand strongly last year, withstanding the shock presented by the Russian invasion in Ukraine. Significant government measures to alleviate the negative effects from soaring energy prices, as well as the resilience of the labor market and flourishing tourism, supported economic growth. At 5.5%, the increase in real economic output was markedly higher than we had estimated in our last review (Jul-22: 4.1%), mainly bolstered by surging exports which contributed 5.0 p.p. to the growth result (Eurostat, annual NA; net exports: 2.4 p.p.), chiefly boosted by service exports (+51.6%). Apart from strong travel and transport exports, telecommunication and other business services added forcefully to the overall service export performance. Private consumption added substantially to the 2022 GDP growth outcome as well (2.5 p.p.), while gross fixed capital formation made a smaller positive contribution (0.9 p.p.).

GDP expansion continued in this year's first quarter, recording an increase by 0.5% q-o-q, again benefiting from tailwinds through exports and with investment adding positively. By contrast, private consumption fell, dragging down domestic demand. Despite the strong growth momentum, Spanish real GDP has not returned to its 2019 level, contrary to developments in the euro area (EA) overall, but the Spanish economy looks set to close this gap in the course of the current year. In Q1-23, real GDP was 0.2% below the pre-pandemic level (Q4-19).

While recent Purchasing Manager indices point at an underperformance of the manufacturing sector versus the service sector, the European Commission (EC) sentiment indicators, and some high-frequency activity data, hint at a rather solid economic growth pace for the second quarter

[1] This rating update takes into account information available until 09 June 2023.

as well, with the beginning tourist season likely remaining a key support to economic growth. Drawing on INE data, the number of tourist arrivals over the period Jan-Mar-2023 increased by 41.2% y-o-y, only 3.5% less than compared to the corresponding period in 2019, confirming that the pandemic downturn has been all but overcome.

Lower energy prices on the back of the so-called 'Iberian mechanism', translating into decreasing headline inflation rates, and a solid labor market performance, should generally support private household income alongside further government initiatives to soften the adverse effects linked to the war in Ukraine. Among others, the minimum wage was lifted markedly, as were pensions, backing expectations for private consumption to remain a growth pillar this year.

The Spanish unemployment rate was at a multi-year low in 2022, having decreased to an average of 12.9%, less than half the rate recorded in 2013 (26.1%, Eurostat), but still remaining well above the euro area level (2022: 6.8%). In monthly terms, the rate stood at 12.8% as of Mar-23. Employment growth remains vivid, increasing by 2.3% y-o-y in Q1-23, having averaged 3.8% in 2022 (INE data). Overall wage growth has so far proved relatively tame, compared to soaring inflation rates, partly due to multi-year wage agreements. We will monitor any signs of stronger increases becoming more prevalent.

With regard to underlying structural developments, there has been progress on the back of recent labor market reforms, and there are continued efforts to re-/upskill labor and better integrate young people into the labor market or offer training, while, e.g., pushing back on temporary contracts. The proportion of fixed-term contracts dropped markedly to 14.9% as of Q4-22 (EA: 11.6%). Moreover, the share of young people neither in employment nor in education has trended downward over recent years, and although we note that it has ticked up over the last few quarters, it remains near multi-year lows (Q4-22: 11.0%, EA: 9.4%, 15-24y, LFS, Eurostat). Similarly, long-term unemployment has trended downward, although still posting well above the respective euro area average (Q4-22: 4.7%, EA: 2.5%, 20-64y).

While tighter financing conditions amid more restrictive monetary policy are likely to dampen investment activity to some extent, the deployment of funds from the EU Recovery and Resilience Facility (RRF) is well underway and should significantly aid fixed investment over this and the coming years. According to government estimates, the ongoing implementation of Spain's RTRP may have boosted GDP by roughly 1.3 p.p. last year and could add about 1 p.p. to the growth outcome in 2023.

A third tranche of the RRF funds was disbursed to Spain at the end of March 2023, making Spain a frontrunner among the EU countries in this respect. Among the conditions attached to this disbursement was the entering into force of a new law to streamline and speed up company restructurings. With this third payment, Spain has so far received approximately EUR 37bn, or 53% of the total of EUR 69.5bn in RRF grants.

Spanish authorities have submitted a request for a fourth tranche (6 June 2023), as well as an Addendum to the RTRP, which includes new reforms and investments, and which is to be financed by the EUR 7.7bn in additional transfers resulting from an update to the RRF allocation key in Jun-22 and about EUR 84bn in loans, i.e., fully mobilizing all available funds via the RRF, as well as 2.6bn of funds related to REPowerEU.

We gather that a process of dialogue and consultation with the regional governments, parliamentary groups and social partners is ongoing to define the structuring, objectives and destination of transfers and loans. Among other purposes, the additional transfers will be used to reinforce the PERTEs to strengthen strategic autonomy in the fields of energy, agri-food, industry, technology and digitization. Overall, the Spanish authorities expect the RTRP (incl. the Addendum) to boost the GDP on average by 2.9 p.p. per year between 2021 and 2031.

With regard to the external environment, we expect revitalized tourism to continue to support exports this year, while a slower economic pace among main European trading partners due to accumulation of dampening effects of tighter monetary policy could pose more constraints from the second half of this year. Ultimately, we consider another positive contribution to the expected GDP expansion from net exports likely for 2023, albeit markedly less pronounced than in 2022. With regard to 2024, net exports could exert a broadly neutral effect on economic growth.

Overall, and given the robust development at the beginning of the current year, we pencil in real GDP growth of about 2.2% for 2023, followed by some moderation to 1.6% in 2024, mostly owing to a somewhat slower pace in the winter half 2023/2024. Downside risks relate to renewed increases in energy prices and possibly stronger adverse effects linked to the monetary policy hiking cycle. Spain entered the phase of soaring energy prices from a position of limited dependence on Russian gas and with existing LNG infrastructure. That said, as a net importer of energy and a relatively high weight of energy in its HICP, there remain vulnerabilities to unfavorable energy price developments, also in connection with supplies from North Africa.

Following a long phase of deleveraging in the private sector in the wake of the global financial crisis, current levels of indebtedness for enterprises and private households would offer some capacity to absorb further economic shocks, strengthening underlying economic resilience for the time being. Compared to fellow EU countries, NFC debt-to-GDP (Q4-22: 72.4%) and household debt-to-disposable income (Q4-22: 86.0%) occupy middle ground at this stage, moving at or below their respective levels prior to the outbreak of the pandemic.

Apart from that, constructive medium-term growth prospects remain backed by the envisaged progressing implementation of the abovementioned RTRP initiatives, among others aimed at tackling challenges affecting the labor market and the business environment, and boosting the green and digital transformation. In its pursuit of the digital agenda, Spain can capitalize on a comparatively favorable position among EU countries regarding the EC's Digital Economy and Society Index, which ranks Spain at an overall 7th in the EU-27, and 3rd when it comes to connectivity.

Looking at indicators capturing broader (non-cost) competitiveness, such as the 2022 IMD yearbook, Spain moves in the middle-range among the EU, occupying rank 36 out of an overall 63 countries featured in the ranking. Given that a markedly higher share of firms than on average in the EU reports on business regulation as a major obstacle for long-term investment, there remains scope to improve on the business environment. The latter also holds with a view to access to finance for SMEs, notwithstanding advancements being made on this front. Such issues constitute constraints to productivity to some extent, alongside room to catch up with frontrunners in terms of innovation potential. Measured by the UN's Global Innovation Index, Spain ranges in the mid-field among the EU countries, occupying an overall rank of 29 of a total of 132 countries in 2022.

Underperforming nominal labor productivity compared to the euro area as a whole, especially in terms of per hour worked, is partly a result of relatively weak investment-to-GDP by the business sector in the wake of deleveraging since the global financial crisis. Likewise, comparatively low investment in R&D over a longer phase has had a negative bearing on total factor productivity (TFP), with the abovementioned challenges to access to finance for smaller companies likely a key factor. That said, remedial plans are underway, with the government aiming to lift R&D investment to 2.6% of GDP as of 2026, from a comparatively low 1.5% of GDP in 2022 (EA, 2021: 2.3% of GDP), next to substantial envisaged strategic investment in various fields.

To be sure, potential growth is estimated to have climbed to 1.1% in 2022 following a pandemic dent, moving well above an estimated average of 0.5% in 2010-19 (AMECO data). Spain's potential growth is expected to leap to 1.5% in 2024, exceeding expected rates for the other major euro area economies in the near term. The government is slightly more optimistic in this regard, expecting potential growth of 1.6% from 2024, with labor and TFP as the main drivers.

In light of a less favorable picture regarding real unit labor costs over the last few years when set against main European trading partners and the euro area as whole - although likely distorted by the pandemic phase - wage increases will have to be monitored alongside the evolution of productivity going forward. Shortly before the outbreak of the coronavirus, which dealt a heavy blow to service exports due to muted tourism, Spain's share in global export markets had edged down slightly. Following the marked fall in the first year of the pandemic (-12.5%), it recovered to some extent in 2021 (+3.8%) before improving markedly last year (+9.6%), drawing on Eurostat data on global export volumes.

Institutional Structure

Spain's credit rating continues to benefit from the high-quality institutional framework, also reflected in the latest set of the World Bank's Worldwide Governance Indicators (WGIs), as well as from the substantial advantages coming with the EU/EMU membership. Despite challenges presented by a more fragmented political landscape over recent years, we assess decisive progress regarding the roll-out of RTRP under the current minority government as credit positive, in our view ultimately demonstrating the ability of reaching consensus and following through on policies. We will closely monitor whether the pace of rolling out RTRP measures of late can be maintained, also in the context of the upcoming parliamentary election. We generally expect political commitment to continuing on the reform path including fostering the twin transition to remain firm following the upcoming parliamentary snap election, to be held in July, notwithstanding a possible change of government.

Our favorable assessment of Spain's institutional set-up is buttressed by the WGIs. In the latest vintage of these indicators, referring to the year 2021, the four pillars on which we focus when assessing the institutional quality delivered a little-changed picture compared to the preceding year, with the position of Spain in respective rankings across these four dimensions remaining in line with the median rank of our peer group of A-rated sovereigns, while comparing somewhat less favorably when set against the median of the euro area members.

More specifically, the sovereign maintained its rank of 50 (out of 209 economies) in terms of 'control of corruption', having seen considerable improvements over recent years with regard to this indicator. When it comes to 'rule of law', we note a slight improvement to rank 45/209, while Spain's rank concerning 'voice and accountability' (42) and 'government effectiveness' (45) were almost unchanged.

Concerning the latter, we recall an overall deteriorating tendency since 2016, tying in with a phase of higher government volatility over that period, partly due to the political fragmentation that comes with challenges to reaching a consensus. One example for such challenges can be seen in ongoing contentious appointment procedures concerning the General Council of the Judiciary, which appoints judges to the Constitutional Court and the Supreme Court, an issue that has been ongoing for several years, and over which there is currently disagreement between the governing coalition party, PSOE, and the main opposition party, PP.

Further to the domestic political landscape, the regional and municipal elections held on 28 May 2023 resulted in a significant loss of support for the PSOE and left-wing parties in most of the regions to the benefit of more conservative parties, prompting the prime minister to call a snap election for 23 July 2023, which would otherwise have had to be held by December 2023.

The national election will see all 350 seats to be newly allocated, as well as 208 of the 265 seats in the senate. According to current polls, the conservative People's Party (PP) is in the lead, with a notable gap to the PSOE, but probably not enough support to win an outright majority. The right-wing VOX is currently coming third in opinion polls. Another coalition government and/or possibly another minority government could thus be the outcome. While separatist movements related to Catalonia may have to be monitored, this issue seems to have become somewhat quieter of late, given renewed political concessions over the last few years.

As mentioned above, roll-out of the RTRP measures is well underway, and we assume continuation on this path following the parliamentary election, although the timing may be affected to some extent, depending on the speed of government formation and cohesion of any new alliance. Whilst emphasizing Spain's position as a frontrunner among the EU countries in this regard, the European Parliament Committee on Budgetary Control suggested some improvements in terms of timely publication and ease of access of information e.g. project payments following a recent visit (Feb-23).

We also highlight as positive a wide range of initiatives and reforms to further enhance Spain's high institutional quality. As one of the commitments in the RTRP, the draft law on public service to promote the modernization of the public administration was submitted to Congress in the middle of March this year, underscoring efforts to effective implementation of measures and initiatives, and potentially further strengthening institutional conditions.

In a similar vein, a preliminary draft on the establishment of a register of interest groups including guidance over what constitutes lobbying activities was approved by the Cabinet last November, and a law strengthening the combat against corruption came into force in February 2023, inter alia regulating the protection of persons who report on regulatory infractions. Measures to combat tax evasion and tax fraud were also implemented.

Commitment to driving the green transformation remains pronounced. Among other measures, authorities have committed to phasing out the use of coal by 2030. Latest figures on the overall share of energy from renewable sources, referring to the year 2021, show Spain as being average among the EU countries (ES: 20.7%, EU: 21.8%, Eurostat) in this respect, whilst being significantly more advanced (46.0% vs. EU 37.6%) when it comes to the share of renewable energy in gross electricity consumption. Its (net) greenhouse gas emissions per head count among the lower ones by European comparison. In a bid to boost the greening of the transport sector, the core high-speed rail network, including cross-border, is to be completed by 2030. Further steps toward environmental taxation have been undertaken, e.g. concerning non-reusable plastics packaging, the deposit of waste in landfills and incineration of waste.

Fiscal Sustainability

Whilst seeing improvements in fiscal metrics following the pandemic-related backlash, risks related to fiscal sustainability remain the sovereign's key weakness, currently compounded by significant measures to cushion the negative effects of higher energy prices. The upcoming snap election and a possible change of government add to some extent to uncertainty over public finances stemming from the unpredictable path of the Russian war against Ukraine and associated negative repercussions. Visibility regarding the resilience of tax revenue currently boosted by temporary taxation measures thus remains limited, although we assume recent and envisaged reform measures to be conducive to strengthening the tax base. While higher pension expenditure should weigh on public finances over the next few years, further reforms to enhance sustainability of the pension system adopted this March could have positive longer-term effects. We view risks linked to the banking sector as largely contained at this point in time, but remain vigilant in the context of the ECB's ongoing course of monetary policy tightening. While interest payments are likely to trend upward in the medium term, Spain's debt portfolio overall remains benign, with a relatively long average maturity acting as a mitigating factor.

Against the backdrop of Spain's ongoing economic recovery, its general government deficit was further reduced to 4.8% of GDP last year (2021: -6.9% of GDP), but it remains among the highest in the EU. Boosted by tax receipts and revenue from social contributions on the back of the positive labor market development, total government revenue saw another strong expansion last year (2022: 8.1%, 2021: 12.9%). According to the authorities, affiliation to social security was at a record high last year (Stability Program 2023, SP23).

At the same time, general government expenditure continued to rise, by 3.8% in 2022 (2021: 5.2%), driven by intermediate consumption, public wages and increasing subsidies. Pandemic support was cut back, while support measures to cushion adverse repercussions from higher energy prices weighed heavier on government outlays. In light of the further roll-out of initiatives and reforms under the RTRP, gross fixed capital formation saw another double-digit increase, mounting by 10.7% last year, lifting public investment to 2.8% of GDP, the highest level since 2013.

Drawing on the SP23, support measures adopted to date exceed EUR 35bn (roughly 2.6% of 2022 GDP), through six packages approved between March and December 2022. Among other provisions, the December package saw an extension of the energy price reduction for companies particularly heavily affected until the end of June 2023, whilst with respect to housing, rent increases remain capped at 2% for all of 2023.

Tax measures for 2023 include relief for lower-income earners, as well as a tax reduction for SMEs, expected to be partly financed by a new special tax on non-reusable packaging and temporary taxes in the energy sector, regarding credit institutions and financial credit establishments, as well as a temporary wealth tax. Monthly tax collection data provided by Spain's Tax Agency suggest that overall tax revenue was on a favorable course up to Apr-23, recording an increase by 5.5% y-o-y over the first four months of 2023 (cash basis), driven by personal income tax revenue and VAT.

Given the election announced for July 2023 and the possibility of a different government constellation, uncertainty over the near- and medium-term fiscal outlook has increased somewhat. We understand that the PP's agenda includes tax cuts as well as cutting back on debt. For the time being, we expect the headline deficit to narrow to 3.9% of GDP this year and further to 3.2% of GDP in 2024.

The outgoing government's medium-term strategy is shaped by its priority to address the complex environment presented by the war in Ukraine, which apart from mitigating negative effects on the private sector also includes higher defense spending in a bid to reach 2% of GDP. Still, the government envisages a path of gradual fiscal consolidation in the period to 2026, expecting to see the general government deficit shrink to 3.0% next year and slightly decrease beyond that, which we view as somewhat ambitious, as also the Fiscal Council (AIReF) suggests.

Indexation of pensions is likely to weigh on government spending over the coming years. However, the pension reform measures adopted in Mar-23, aimed at strengthening the financial sustainability of the system and which also include an intergenerational equity mechanism, should be conducive to mitigating fiscal burdens related to ageing. A broader set of envisaged tax reforms, which are also to take into account the recommendations made by a committee of experts, in our view highlight efforts that focus on longer-term fiscal sustainability, although actual designs and implementation will have to be monitored further. We will therefore be looking for clearer signs of revenue increases being achieved on a more structural basis, rather than due to special/temporary tax measures as described above.

Against the backdrop of strong nominal GDP growth and the decreasing headline deficit, Spain's public debt ratio shrank by 5.1 p.p. to 113.2% of GDP in 2022, still representing one of the highest levels among the EU members. In light of our assumptions for economic growth and the general government budget outturn, we expect debt-to-GDP to drift further downward to about 110.4% of GDP this year and 109.1% of GDP in 2024, remaining still well above its pre-pandemic level (2019: 98.2% of GDP).

Looking at contingent liabilities potentially weighing on debt prospects, the total stock of public guarantees was down to EUR 27.4bn last year (2.1% of 2022 GDP) after reaching a peak in the first pandemic year, 2020 (10.7% of GDP). Spain's banking sector has continued to weather the recent turbulent phases well. Asset quality measured by the NPL ratio has further improved, concluding the year 2022 at 2.8% (Q4-21: 3.0%, EBA data), whilst remaining above the EU level (Q4-22: 1.8%). The reduction was mainly due to banks' sales of non-performing loans. In this context, we note that bad bank SAREB has reduced its portfolio by 48% and repaid 40% of the initial debt between its inception in 2012 and the end of 2022.

Further to legacy issues in Spain's banking sector, we gather that a deadline for the divestment of CaixaBank by the Fund for Orderly Bank Restructuring (FROB), which holds 50.14% in SAREB's capital, was postponed to the end of 2025. In Feb-23, Spanish banks' use of TLTRO funding provided by the ECB had decreased to the lowest level since Mar-20 (EC intelligence).

Stage 2 loans declined in the year to Q4-22, moving below the EU level. According to data provided by Banco de Espana (BdE), the NPL ratio was down to 3.5% in Dec-22, corresponding to the lowest level since Dec-08. As illustrated by the CET1 ratio, capital buffers continue to compare as less favorable against the EU level. In fact, at 12.6% as of Q4-22 (EBA data), Spain's CET1 ratio represented the lowest among the EU countries.

As mentioned above, the banking sector is currently faced with a temporary bank levy introduced in 2022, to be paid on the 2022 results in 2023 and 2023 results in 2024, and expected to generate revenue of roughly EUR 1.3bn per year, although this policy has been legally challenged by some financial institutions.

In view of higher financing costs amid tightening monetary policy, we highlight that variable-rate mortgages represent about 74% of the outstanding credit stock. At the same time, the volume has been reduced significantly over recent years, with 70% of mortgages signed in 2021/22 being at fixed rates. The Code of Good Practices for banking entities has been strengthened to provide a range of options to mortgage debtors and cushion the impact of the rise in interest rates. In terms of macroprudential measures, we note that BdE in Mar-23 decided to hold the countercyclical capital buffer 0% in Q2-23, in the absence of a buildup of endogenous systemic risks and an expected decline in credit-to-GDP gap.

Meanwhile, the housing market has been slowing, as mirrored in downward-trending house purchases, declining mortgage lending and less dynamic house price developments. Moreover, the most recent ECB Bank Lending Survey reports on tightening credit standards for housing loans and consumer credit in Spain, as well as substantially decreased net demand for housing loans. Drawing on Eurostat data, annual growth in Spanish house prices has decreased to 5.5% as of Q4-22. Whilst still in double digits (Q4-22: 19.1%), the 3-year rate of change seems to be past its peak now.

On the back of tightening monetary policy, the yield on 10-year Spanish bonds saw a strong increase starting in 2022, reaching 3.60% as of 26 May-23 (weekly data), its highest level since Feb-14, while the spread vis-à-vis 10y German Bunds, at 107bp, remained well below 2014 levels. Interest payments thus recorded a marked increase in 2022 (+21.3%), but came to a relatively moderate 2.4% as measured against GDP. Measured against total revenue, debt servicing cost stood at 5.5% last year. Judging by data provided by the Finance Ministry, the average cost of outstanding debt rose further from 1.73% in 2022 to 1.90% as of May-23.

That said, the average maturity of debt stood at 7.89y as of the end of May-23 (2022: 7.86y), mitigating refinancing risks as part of ongoing sound debt management and an overall benign debt profile, including a 40% share of government debt held by the official sector as of Q2-22 (IMF data). In this context, we also recall the planned annual repayment of the ESM loan until 2027. As per schedule, Spain repaid EUR 3.6bn in Dec-22, with a similar amount expected to be repaid in 2023.

Spanish government debt held by the Eurosystem is to shrink gradually going forward. Whilst the ECB envisages to continue reinvesting the principal payments from maturing securities purchased under the Pandemic Emergency Purchase Program (PEPP) until at least the end of 2024, a gradual winding down of the Asset Purchase Program (APP) portfolio began in March 2023 with an initial monthly portfolio reduction of EUR 15bn until June 2023. The ECB expects to discontinue the reinvestments under the APP as of July 2023, corresponding to an accelerated shrinking of its balance sheet. Apart from that, we currently expect two more interest rate hikes by the ECB this year following the decision in May-23, presumably by 25bp each, while we consider a first lowering unlikely to occur before 2024.

Foreign Exposure

We continue to flag some external risks for the sovereign, reflected in a large negative net international investment position (NIIP), although partly mitigated by persistent current account surpluses despite the recent succession of crises, as well as by the composition of the NIIP.

Despite a challenging external environment and turbulent energy price developments following Russia's military attack on Ukraine, Spain posted an eleventh consecutive current account surplus in 2022, even though it shrank to 0.6% of GDP. While soaring energy prices had the goods trade deficit balloon to 4.4% of GDP last year, the strong export performance regarding services including recovering tourism almost offset this effect, increasing the surplus in the service account to a new high of 5.8% of GDP. On the back of receding energy prices and related improvement of terms of trade, we expect Spain's current account to post a higher surplus again going forward.

The repeatedly positive current account balance continues to mitigate vulnerabilities associated with Spain's still pronounced net debtor position vis-à-vis the rest of the world. In addition, the highly negative NIIP has markedly improved over recent years, and was significantly reduced, by 11.0 p.p., to -60.5% of GDP in 2022. External risks are further mitigated by the composition of the NIIP, as reflected by the respective position stripped of non-defaultable instruments (NENDI), which dwindled to -30.8% of GDP last year. Moreover, external liabilities are dominated by government and central bank debt, also representing a risk-mitigating factor.

Rating Outlook and Sensitivity

Our rating outlook for the Kingdom of Spain's long-term credit ratings is stable. Expectations of a constructive medium-term growth outlook amid the well-advancing implementation of RTRP measures and Spain's institutional strengths balance vulnerabilities associated with the elevated - although assumed decreasing - public debt ratio and external exposure.

We could consider a negative rating action if, contrary to our expectation, medium-term growth prospects worsen significantly, entailing negative repercussions for the public debt ratio in particular. Further escalation of the war in Ukraine, likely associated with extended/enhanced government support, could be part of such a scenario, as could a significant slowdown in the implementation of the RTRP and a respective delay of disbursements, possibly as a consequence of difficulties in striking political agreements following the election.

On the other hand, raising the sovereign's credit rating or outlook could be prompted by further significant labor market improvements markedly strengthening the medium-term growth outlook alongside a positive impact of RTRP implementation. Growing confidence over resilience in tax revenue, boosting expectations of a sustainable downward trend of the debt ratio, could also act in favor of a positive rating action.

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Ratings*

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

*) Unsolicited

ESG Factors

Creditreform Rating has signed the ESG in credit risk and ratings statement formulated within the framework of the UN Principles for Responsible Investment (UN PRI). The rating agency is thus committed to taking environmental and social factors as well as aspects of corporate governance into account in a targeted manner when assessing creditworthiness.

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

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

ESG Factor Box

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

Environment	Social	Governance	Highly significant	Significant	Less significant	Hardly significant

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

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

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

Economic Data

[in %, otherwise noted]	2017	2018	2019	2020	2021	2022e	2023e
Macroeconomic Performance							
Real GDP growth	3.0	2.3	2.0	-11.3	5.5	5.5	2.2
GDP per capita (PPP, USD)	39,648	41,354	42,587	38,055	41,921	47,111	49,448
Credit to the private sector/GDP	120.5	111.2	105.6	122.1	108.9	97.6	n/a
Unemployment rate	17.2	15.3	14.1	15.5	14.8	12.9	n/a
Real unit labor costs (index 2015=100)	97.8	98.1	100.3	107.6	104.9	101.1	100.5
World Competitiveness Ranking (rank)	34	36	36	36	39	36	n/a
Life expectancy at birth (years)	83.4	83.5	84.0	82.4	83.3	n/a	n/a
Institutional Structure							
WGI Rule of Law (score)	1.1	1.0	1.0	0.9	0.9	n/a	n/a
WGI Control of Corruption (score)	0.5	0.6	0.7	0.7	0.7	n/a	n/a
WGI Voice and Accountability (score)	1.0	1.0	1.0	1.0	1.0	n/a	n/a
WGI Government Effectiveness (score)	1.0	1.0	1.0	0.9	0.9	n/a	n/a
HICP inflation rate, y-o-y change	2.0	1.7	0.8	-0.3	3.0	8.3	3.9
GHG emissions (tons of CO2 equivalent p.c.)	7.6	7.4	7.0	5.9	6.3	n/a	n/a
Default history (years since default)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Fiscal Sustainability							
Fiscal balance/GDP	-3.1	-2.6	-3.1	-10.1	-6.9	-4.8	-3.9
General government gross debt/GDP	101.8	100.4	98.2	120.4	118.3	113.2	110.4
Interest/revenue	6.6	6.2	5.8	5.4	4.9	5.5	n/a
Debt/revenue	266.5	256.0	250.4	287.8	270.4	263.4	n/a
Total residual maturity of debt securities (years)	6.9	7.4	7.5	7.8	7.9	7.8	n/a
Foreign exposure							
Current account balance/GDP	2.8	1.9	2.1	0.6	1.0	0.6	n/a
International reserves/imports	19.7	18.1	20.0	24.9	22.0	18.9	n/a
NIIP/GDP	-85.5	-79.1	-73.7	-85.7	-71.5	-60.5	n/a
External debt/GDP	168.1	168.1	169.8	199.8	193.4	175.7	n/a

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

Appendix

Rating History

Event	Publication Date	Rating /Outlook
Initial Rating	30.09.2016	BBB+ /stable
Monitoring	01.09.2017	BBB+ /positive
Monitoring	27.07.2018	A- /stable
Monitoring	26.07.2019	A- /stable
Monitoring	24.07.2020	A- /negative
Monitoring	22.01.2021	A- /negative
Monitoring	16.07.2021	A- /negative
Monitoring	15.07.2022	A- /stable
Monitoring	16.06.2023	A- /stable

Regulatory Requirements

In 2011 Creditreform Rating AG (CRAG) was registered within the European Union according to EU Regulation 1060/2009 (CRA-Regulation). Based on the registration Creditreform Rating AG is allowed to issue credit ratings within the EU and is bound to comply with the provisions of the CRA-Regulation. The rating was not endorsed by Creditreform Rating AG from a third country as defined in Article 4 (3) of the CRA-Regulation.

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

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

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

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

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

As regards the rating outlook, the time horizon is provided during which a change in the credit rating is expected. This information is available within the credit rating report. There are no other attributes and limitations of the credit rating or rating outlook other than displayed on the

CRAG website. In the event of providing ancillary services to the rated entity, CRAG will disclose all ancillary services in the credit rating report.

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

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

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

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