NEWS RELEASE

Apr 03, 2023

R&I Affirms A, Stable: Kingdom of Spain

Rating and Investment Information, Inc. (R&I) has announced the following:

ISSUER: **Kingdom of Spain**

Foreign Currency Issuer Rating: A, Affirmed
Rating Outlook: Stable

RATIONALE:

The Spanish economy, which has been slowing down due to the impact of high energy prices and other factors, is highly likely to head for recovery and return to growth as prices stabilize. In 2023, the economic growth rate is expected to be above the average of Eurozone member states. It is unlikely that the strength of the economic fundamentals is undermined. The fiscal balance is improving, and the government debt ratio is falling. R&I has affirmed the Foreign Currency Issuer Rating at A, also taking into account that the country maintains the stability of financial system among other factors.

The country's industrial profile consists of the manufacturing, particularly the automotive sector, and the service sector such as tourism. After a significant negative growth of real gross domestic product (GDP) in 2020 under the COVID-19 pandemic, Spain's economy has recovered steadily owing to the removal of movement restrictions as well as the revival of tourism demand. The economy grew by 5.5% in 2022. Inflation had risen to the 10% level at its peak due to higher gas prices in Europe and the electricity fee system closely pegged to the market price, but fell to a level under the Eurozone average in 2H 2022. Nonetheless, Spain's core inflation rate is still as high as the euro area average. This will weigh on the domestic demand, along with the tightening policy by the European Central Bank. In contrast, the tourism demand is expected to support the economy continuously and the European Commission forecasts real GDP growth of 1.4% in 2023, which outperforms the Eurozone average.

The banking sector's earnings have improved thanks partly to the effects of rising interest rates. The non-performing loans ratio has continued to drop, staying in a 3% range. Although the capital adequacy ratio of the banking sector as a whole is slightly lower than that of major euro area member countries, the stress test by Bank of Spain, the central bank, shows that the sector is able to maintain a sufficient level even under the scenario of considerable deterioration in terms of economic and financial environments. The government introduced temporary windfall levies on net interest income etc. of financial institutions, which will apply in 2023 and 2024. Although the business situation of financial institutions is currently favorable, the levies would create additional cost burdens if the financial environment changes. Eyes are on the impact of new levies including how the government will handle them in the future.

The fiscal deficits, which expanded to 10.1% of GDP in 2020, are improving on the back of the scaling down of measures to handle the COVID-19 pandemic and the increased tax revenue reflecting the economic recovery. Despite the measures introduced to cushion the impact of rising energy prices, its burden has been absorbed by solid tax earnings. In 2022, the fiscal deficit is expected to have fallen below the 5% projection by the government. As for 2023, a 3.9% deficit is planned under the government's budget. While there are some factors that warrant a wary eye, such as the economy's downside risk and additional spending to deal with the inflation, there is still room for maneuver for the government. R&I takes the view that the fiscal deficit will basically decrease to a level close to the government plan.

After climbing to about 120% in 2020, the outstanding government debt to GDP ratio has been on a downward trend. In 2022, the ratio dropped by more than 5 percentage points to around 113% from 2021. The government debt affordability is sufficiently solid, as seen in the burden of interest payment hovering in the 2% range to GDP as well as the remaining maturity of the debt outstanding reaching as long as approximately 8 years. In the meanwhile, further consolidation efforts will be needed to bring the government debt ratio onto a stable downward trend even after the expiration of temporary levies on

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energy companies and financial institutions. Attention should be paid to the government's medium term strategy, along with the result of general election scheduled to take place by the year-end of 2023.

The primary rating methodology applied to this rating is provided at "R&I's Analytical Approach to Sovereigns". The methodology is available at the web site listed below, together with other rating methodologies that are taken into consideration when assigning the rating.
https://www.r-i.co.jp/en/rating/about/rating_method.html

R&I RATINGS:

ISSUER:	**Kingdom of Spain**
	Foreign Currency Issuer Rating
RATING:	**A, Affirmed**
RATING OUTLOOK:	**Stable**

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