



*Update on Policy measures towards a  
sustained and balanced growth path*

December 2011

## Highlights

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The reforms and macroeconomic developments in 2010 and 2011 are laying the foundations of a sound and rebalanced growth for the Spanish economy

Two main questions:

- Are reforms during the last 2 years tackling the underlying problems? Existing evidence on fiscal consolidation, financial system reform, labour market reform, business environment says so

Still some existing challenges have fostered new policies demonstrating the absence of reform fatigue and willingness to further underpin fiscal sustainability and labour market reforms to foster growth

- Can Spain grow? Spain has a diversified and competitive economy with enough resources to enhance growth in the future



- **Reform strategy: fiscal, financial and factor markets**
- **Structural and economic rebalancing**
- **Funding and Debt Management**

## Fiscal consolidation (I)

**Objectives** – regardless of macroeconomic performance

- Short-term: fiscal target of 6% deficit in 2011
- Establishing a more transparent framework
- Ensuring long-term fiscal stability

### Instruments

- On-going commitment to deficit reduction
- Constitutional change limiting structural deficit and debt
- New spending rule: public spending linked to economic growth
- Pension reform: higher age of retirement, greater relationship between contribution and pension and sustainability factor

Approved 27/09/2011

Approved 14/07/2011

Approved 21/07/2011

General Government commitments by unit (% of GDP)							
	2009	2010		2011	2012	2013	2014
		Commitment	Execution				
<b>General Government</b>							
<b>Budget Balance</b>	<b>-11.2</b>	<b>-9.3</b>	<b>-9.3</b>	<b>-6.0</b>	<b>-4.4</b>	<b>-3.0</b>	<b>-2.1</b>
Central Government	-9.3	-5.9	-5.0	-2.3	-3.2	-2.1	-1.5
		(-6.7)	(-5.7)	(-4.8)			
Autonomous Communities	-2.0	-3.1	-3.5	-3.3	-1.3	-1.1	-1.0
		(-2.4)	(-2.8)	(-1.3)			
Local Governments	-0.6	-0.6	-0.6	-0.8	-0.3	-0.2	0.0
		(-0.4)	(-0.5)	(-0.3)			
Social Security	0.8	0.2	-0.2	0.4	0.4	0.4	0.4
<b>General Government</b>							
<b>Debt over GDP</b>	<b>53.8</b>	<b>62.8</b>	<b>61.0</b>	<b>67.8</b>	<b>68.5</b>	<b>69.3</b>	<b>68.9</b>

Source: *Stability Programme Update 2011-2014* and *Eurostat*.  
 In brackets: net of internal transfers among Public Administration units.

## Fiscal consolidation (II)

### The Central Government up to October 2011 (EDP) delivers on its commitment

- The cumulative deficit stands at €40.1 billion (-16.9 % yoy)

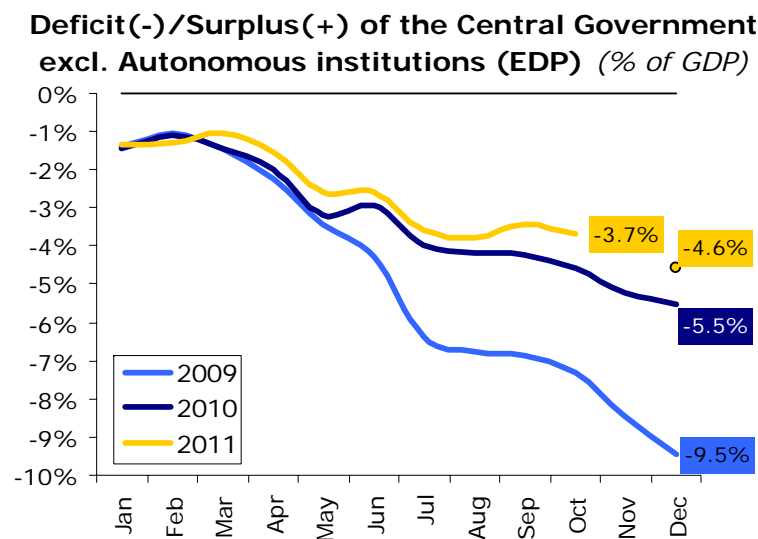
#### Additional measures:

- Changes in corporate tax, pharmaceuticals and wealth tax:  
Saving 2,980 M€ in 2011, 3,880 M€ in 2012, 3,800 in 2013

Approved 19/08/2011  
and 16/09/2011

- Deposit Guarantee Fund privately funded to absorb FROB losses derived from the recapitalization process

Approved 21/10/2011



Source: [IGAE](#). Net of internal transfers.  
Target of Central Government for 2011 (-4.8%).  
Autonomous Institutions add 0.2% deficit, as in 2010.

## Fiscal consolidation (III)

### Autonomous Communities

- **Execution:** deficit of 1.19% of GDP up to Q3-2011. Regional Governments exceeding a 0.75% deficit under evaluation
- **Monitoring:** authorisation for new issuance extended in three stages conditional on compliance with targets
- **Ongoing Measures:**
  - Homogeneous reporting of approved regional rebalancing plans Published 18/10/2011
  - Future reporting of budget execution on National Account basis
  - Approval of expenditure rules consistent with the approved on July 1st for the Central government
  - Constitutional change to limit structural deficit Council agreements 27/07/2011

## Financial sector reform (I)

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### **Restructuring:**

- 13.2% reduction in branches and 10.5% staff since 2008
- The number of savings banks has decreased from 45 to 15 in less than two years

### **Corporate governance:**

- Over 90% of the assets managed by savings banks transferred to commercial banks
- Governance structure improved by means of a Law

### **Transparency:**

- 93% of the financial sector in July 2011 stress tests.
  - 5 institutions below 5% of CORE TIER 1
  - No Spanish institution requires additional capital on top of the existing commitments as they count on enough paid-up mitigating instruments
- Quarterly reporting on exposure and impaired assets since January 2011

## Financial sector reform (II)

### Solvency:

- **February 2011:** solvency requirements increased to 8%/10%
- **March 2011:** Identification of capital requirements by the Bank of Spain to reach these new thresholds: 13 institutions which amounted to around €17 billion
- **July 2011:** 4 banks and 2 savings banks had already met their capital needs (€4.5bn) through private funds. One saving bank has done so through public funds (€2.8bn)
- Three savings banks already listed (accounting for 50% savings banks' assets) raised €5.2b capital
- **September 2011:** End of capitalisation process → 9 groups private capitalisation (€7.0bn), 4 groups FROB (€7.6bn).

	Capital	Capital ratio required	Capital needs (€ mn)	Recapitalisation alternative	Status
Bankinter	2,144	8.0	333	Instruments qualified as capital	√
Bankpyme	24	8.0	8	Integration with another institution	√
Barclays Bank, S.A.	1,005	8.0	552	Parent company	√
Deutsche Bank, S.A.E.	729	8.0	182	Parent company	√
Bankia	14,125	10.0--->8.0	5,775--->1,795	Stock market listing, July 2011	√
Banca Cívica	3,687	10.0--->8.0	847--->0	Stock market listing, July 2011	√
Caja España	2,062	10.0	463	Integration with another institution	√
Catalunya-Caixa	3,148	10.0	1,718	FROB	√
Grupo BMN	3,343	10.0	637	Private investors	√
Novacaixagalicia	2,851	10.0	2,622	FROB	√
Unimm	1,150	10.0	568	FROB	√
CAM		10.0	2,800	FROB	√
Liberbank		10.0	519	Private investors	√

Source: [Bank of Spain](#) and CNMV.

## Labour market reform (I)

- The first challenge of the Spanish labour market is related to the distribution of work among workers. Spain does not have a problem on the overall labour utilization
- Measures to increase flexibility and reducing the Spanish traditional high responsiveness of employment to negative activity shocks

### Changes in unemployment and labour potential (Quarterly hours worked/potential hours of pop 15-64)

Unemployment and labour utilization				
	Unemployment	Change vs 2003-Q1 (In p.p.)	Labour utilization	Change vs 2003-Q1 (In p.p.)
Germany	6.8%	-3.1	51.7%	2.4
Italy	8.7%	-0.5	52.9%	-1.5
France	9.6%	1.0	46.4%	-0.7
Ireland	14.2%	9.5	52.3%	-8.0
Spain	21.4%	9.4	48.3%	-2.5

Source: [Eurostat](#).

Note: Quarterly potential hours are defined as 13 weeks working 40 hours/week.

### Some data on labour market reform

Hiring and dismissals (Year-on-year growth rates)		Pre-reform period			Post-reform period		
		May	June	July	Avg rest 2010	Avg 2011	
Dismissals (% over firings)	Objective	16.7	17.2	18.5	20.5	23.9	
	Disciplinary	66.6	67.1	65.7	65.1	60.6	
	Other*	16.8	15.7	15.8	14.4	15.4	
Collective restructuring processes (% over total)	Other	96.0	97.4	90.5	75.2	75.2	
	German model	4.0	2.6	9.5	24.8	24.8	
Wage developments		2009	2010Q1	2010Q2	2010Q3	2010Q4	2011Q1
	Collective agreements**	2.7	1.5	1.3	1.3	1.3	3.0
	Real wage	3.5	0.9	0.2	-1.8	-2.5	-2.5
	Real labour cost	3.8	0.0	-0.4	-2.2	-2.8	-2.7
	Modification collective agreements (% workers with agreement)				8%		

Source: *Ministerio de Economía y Hacienda*.

## Labour market reform (II)

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### Hiring:

- Promotion “Contrato de Fomento”
  - Improved definition of causes of fair dismissal
  - Lower severance costs for employers at the moment of dismissal
  - “German Model”: incentivises working-day reduction instead of dismissal or suspension.
  - Internal flexibility: facilitates opting out from higher-level collective agreements if the company is under economic stress.
- 
- Training contract for young people
  - Elimination for next 2 years any limitation to roll over temporary contracts

Approved 19/09/2010

Approved 26/08/2011

### Collective bargaining:

- Incentives for firm-level collective agreements
- Incentives for renegotiating new collective agreements before the expiration of the previous agreement

Approved 22/06/2011

## Labour market reform (III)

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- Unemployment rate is high (22.2%) mostly due to construction job losses. Thus, the second challenge is to reallocate 2M workers
- Even in the crisis trough high unemployment-employment flows:
  - Quarter-to-quarter transition unemployment-employment 22%
  - 25% for unemployed previously working in construction
- Active labour market policies should enhance the reallocation:
  - Incentives part time hiring
  - Personalised career advice
  - Introduction of an unemployment assistance grant, conditional upon training courses once unemployment benefit has run out
  - Creation of private employment agencies

Approved 11/02/2011

## Product market reforms

### SMEs:

- Business angels: Exemptions on capital gains for entrepreneurial projects up to €25,000
- Taxation: Reduction of the corporate tax rate for SMEs, 20%-25% depending on their size
- Liquidity: Payments to suppliers by municipalities have been facilitated. An ICO line has been set up to pay suppliers directly, with the guarantee provided by local entities' future revenues

Approved 03/12/2010  
and 07/07/2011

**Enterprise incorporation:** maximum time limit of five days for more than 80% of companies

**Bankruptcy Law:** facilitates the viability of companies undergoing difficulties through agreements with creditors

**Extension of the free amortisation tax scheme for new investments**

Approved 23/08/2011

**VAT for housing purchase reduced temporarily** to 4% from 8%

## Sector restructuring and Privatisation underway

Airports	Lotteries	Telecommunications
<ul style="list-style-type: none"> <li>● Separation of airport operation and traffic control</li> </ul> <p><i>(Completed in February 2011)</i></p>	<ul style="list-style-type: none"> <li>● New gambling law               <ul style="list-style-type: none"> <li>▪ Separation of regulation and operation</li> <li>▪ Regulation of on-line gambling</li> </ul> </li> </ul> <p><i>(Approved in May 2011)</i></p>	<ul style="list-style-type: none"> <li>● Introduction of technological neutrality in the usage of spectrum</li> <li>● Reallocation of the TDT extra-spectrum to telephone services</li> </ul>
<ul style="list-style-type: none"> <li>● Major airports concessioned to private operators</li> </ul> <p style="text-align: center; border: 2px solid red; padding: 5px;"><i>Postponed</i></p>	<ul style="list-style-type: none"> <li>● Privatisation of 30% of the National Lottery</li> </ul> <p style="text-align: center; border: 2px solid red; padding: 5px;"><i>Postponed</i></p>	<ul style="list-style-type: none"> <li>● Spectrum auction</li> </ul> <p style="text-align: center; border: 2px solid red; padding: 5px;"><i>Jul-Sep 2011</i></p>
<ul style="list-style-type: none"> <li>● Privatisation of up to 49% of the National Airport System</li> </ul> <p style="text-align: center; border: 2px solid red; padding: 5px;"><b>1st quarter 2012</b></p>		
Expected revenues (in € bn): <p style="text-align: center;">3-4</p>	Expected revenues (in € bn): <p style="text-align: center;">7-9</p>	Expected revenues (in € bn): <p style="text-align: center;">1.8-2.0</p>

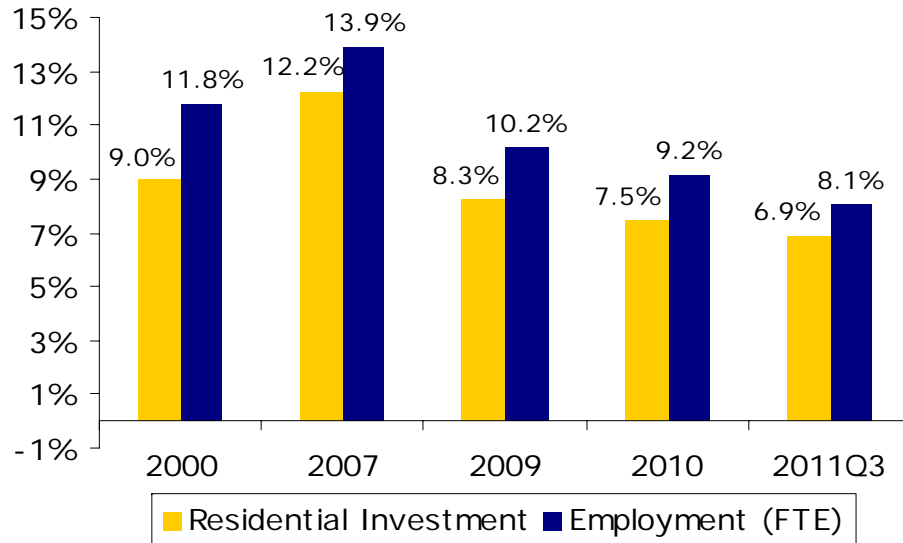
- **Reform strategy: fiscal, financial and factor markets**
- **Structural and economic rebalancing**
- **Funding and Debt Management**

## Rapid downsizing of the residential construction sector

- Residential investment accounted for 9% of GDP in 2000 and it increased to 12.2% in 2007. In 2011 this ratio is already below 7%
- Stock of unsold houses (estimated at 725,000 in 2010) will continue to shrink in 2011

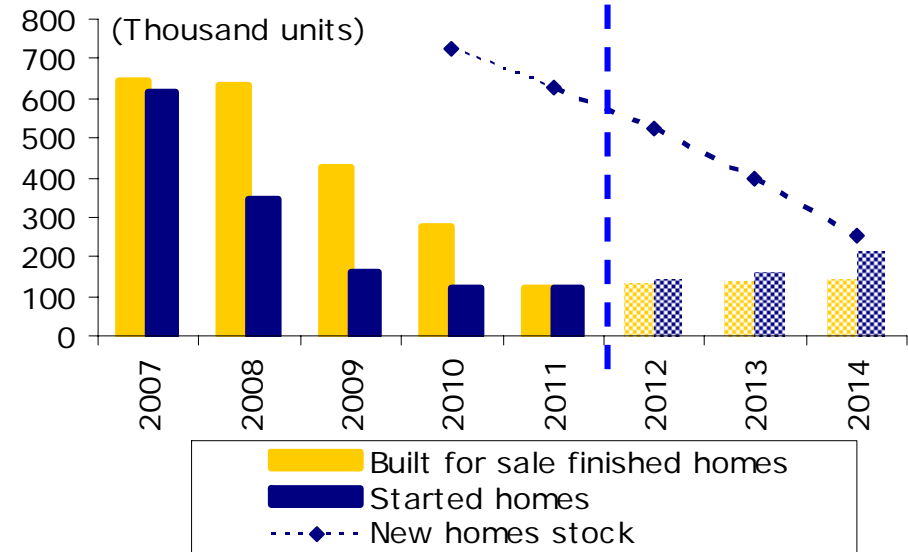
### Relative size of the construction sector

(employment over total employment and residential investment over GDP)



Source: [INE](#).

### Housing: units started and finished

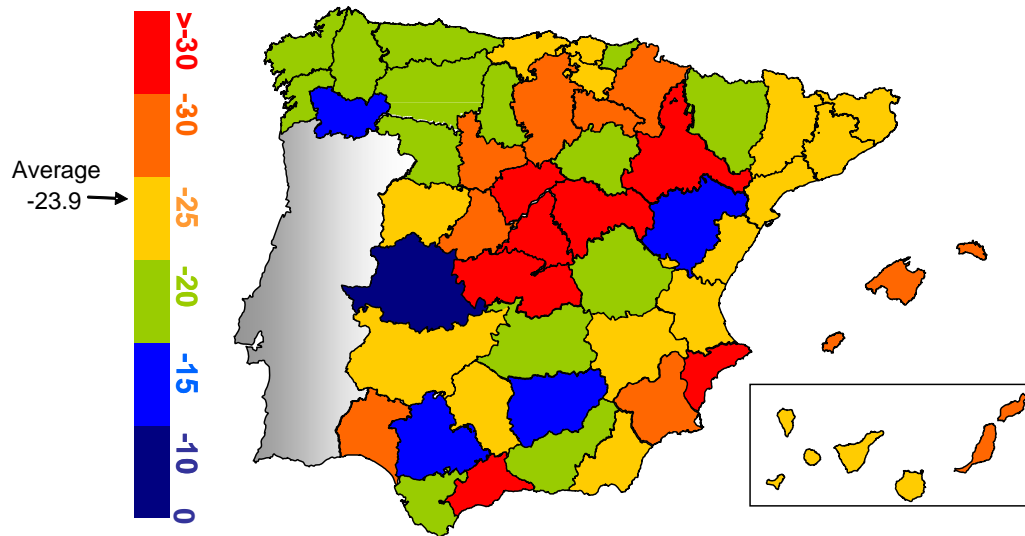


Source: *Ministerio de Economía y Hacienda*.

## Housing stock is shrinking and prices are adjusting

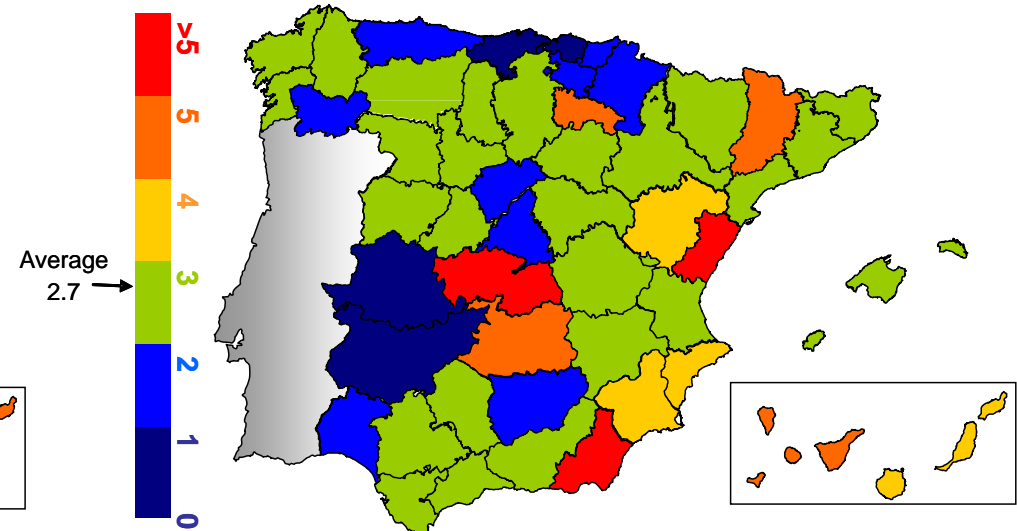
- A gradual reduction in the stock of unsold houses and trend housing demand (approx. 350.000 units), will normalise the sector's macroeconomic impact
- The adjustment in housing prices is more intense in the Mediterranean coastline as well as in Madrid and its surroundings

**Real price adjustment of used houses per Province**  
(From peak in each Province to 2011-Q3 in percent)



Sources: [Ministerio de Fomento](#).

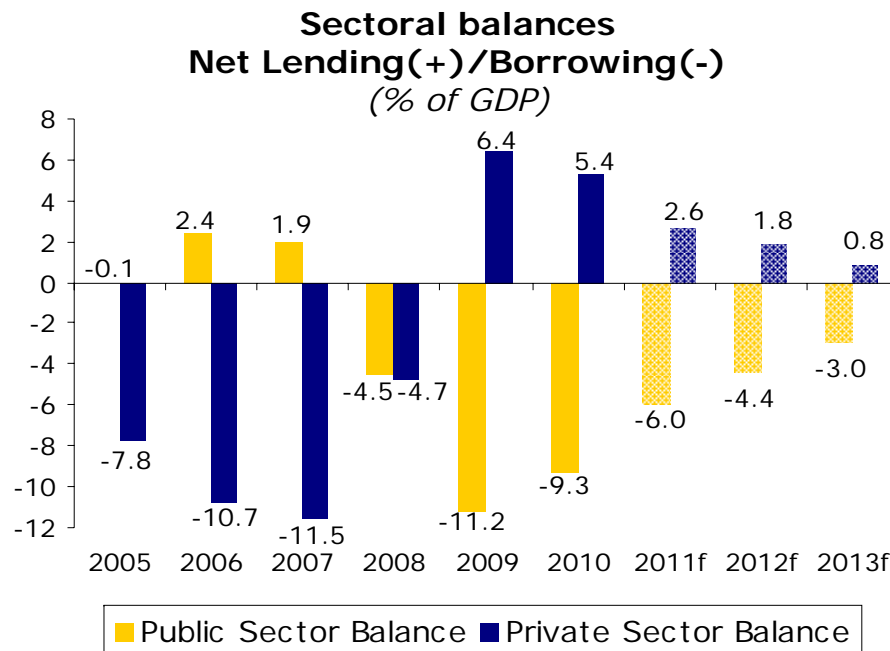
**Unoccupied housing stock per Province**  
(2010, in percent of total stock in each Province)



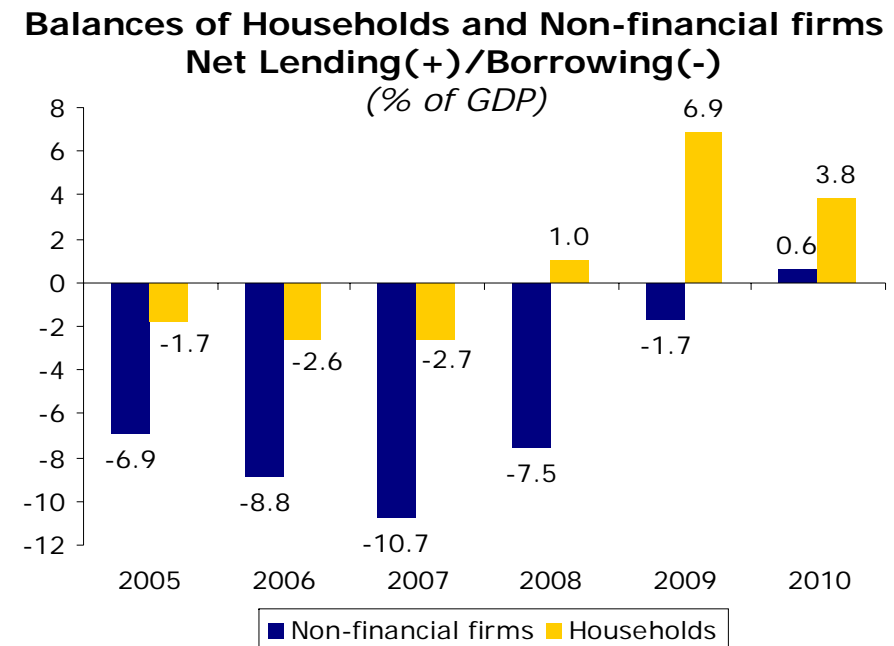
Source: [Ministerio de Fomento](#).

## Intense adjustment of households and non-financial firms

- High leverage was concentrated in real estate and construction
- Non-financial firms have also invested heavily abroad, seizing opportunities of global markets
- Deleveraging process in households is compatible with moderate consumption growth
- Credit growth will gradually approach nominal GDP growth



Source: [INE](#) and [Ministerio de Economía y Hacienda](#).



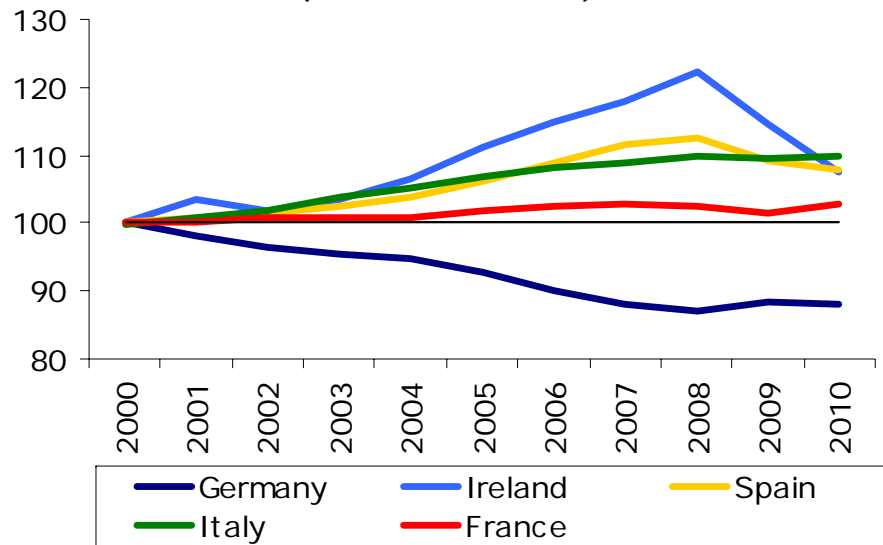
Source: [INE](#).



## Recent trends in price competitiveness...

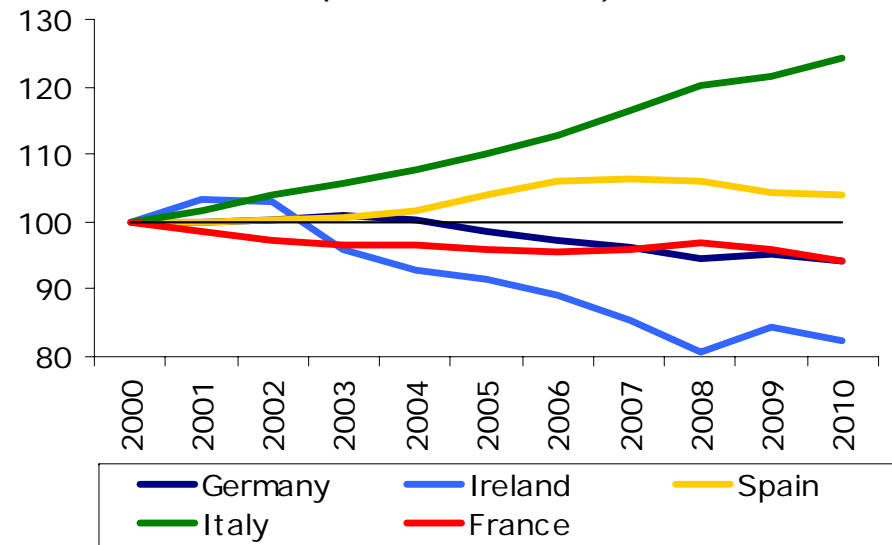
- Between 2000 and 2008, Spain faced an increase in labour costs relative to its European peers
- Price competitiveness has been improving due to the rebalancing and structural adjustment of the Spanish economy

**ULC Indexes relative to the Euro Area**  
(Index 2000=100)



Source: [Eurostat](#).

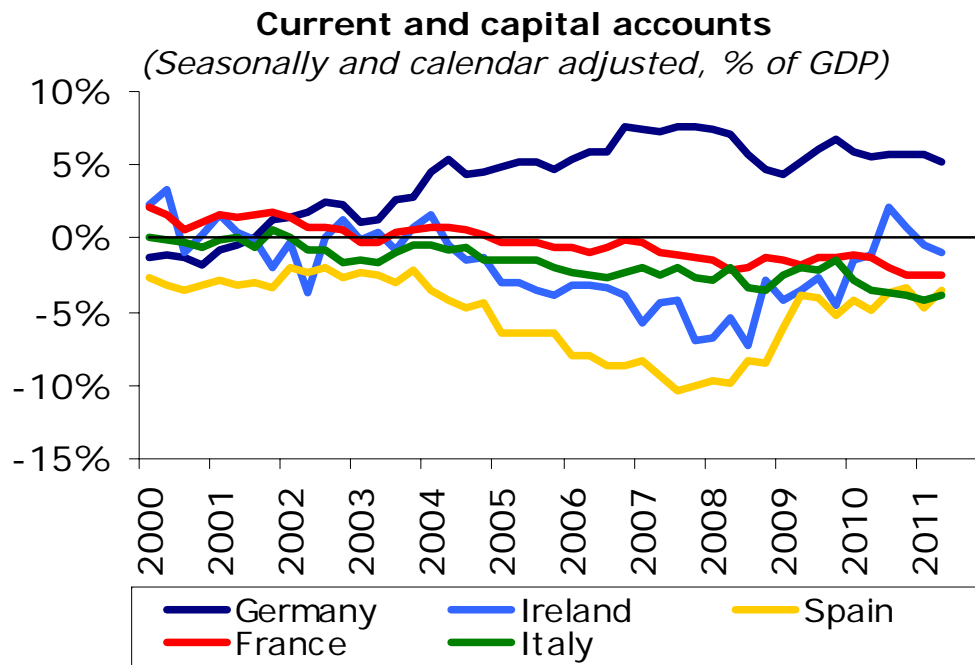
**Export price indexes relative to the Euro Area**  
(Index 2000=100)



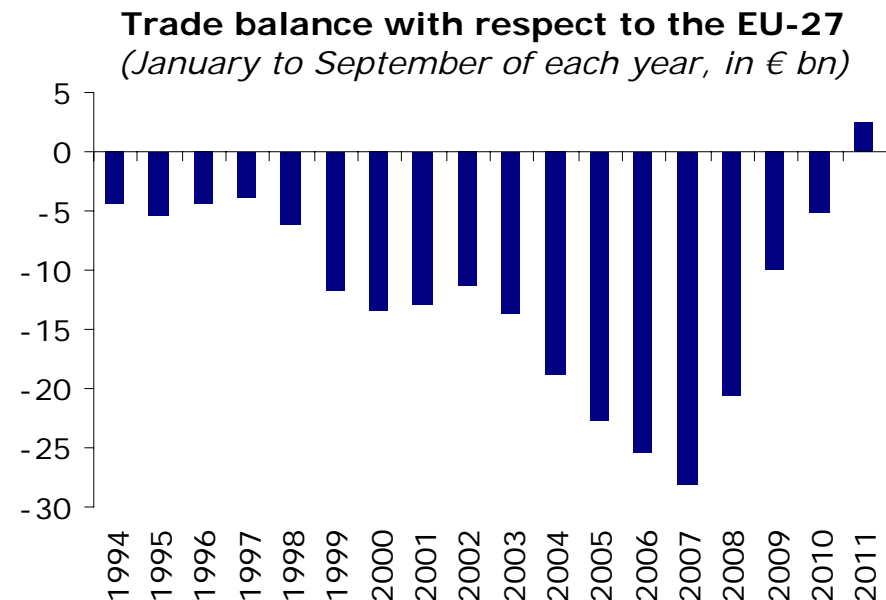
Source: [Eurostat](#).

## ...are bolstering exports...

- The net borrowing of 11.4% of GDP in 2008-Q1 has shrunk in 2011-Q2, partly attributed to the adjustment in the residential real estate sector
- The current account deficit is adjusting due to the strong export performance. Exports are reacting to the downward pressure on domestic prices and labour cost moderation



Source: [Eurostat](#).

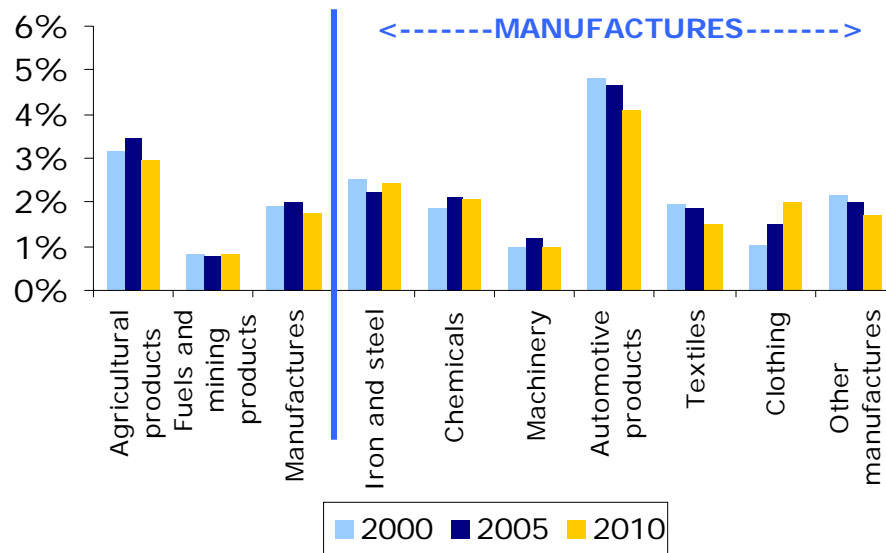


Source: [Ministerio de Economía y Hacienda](#).

## Spanish firms are competitive in a variety of sectors

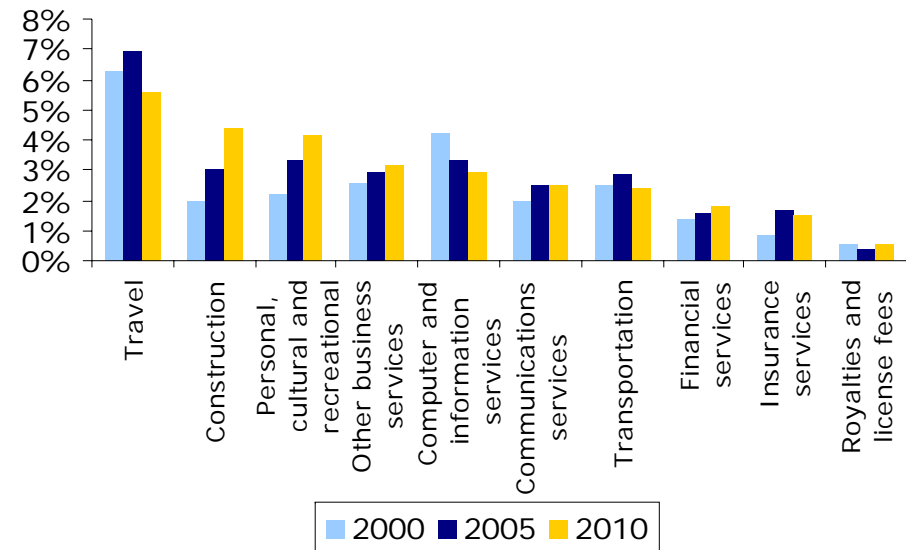
- Resilience of market share in world merchandise and of service exports other than transportation and tourism-related services
- Spanish exports are entering in new emerging markets: in 2009 (1999) 78.8% (82.5%) went to OECD and 56.7% (60.2%) to the Euro Area

Share in world merchandise exports by product



Source: [World Trade Organisation](#).

Share in world exports of commercial services



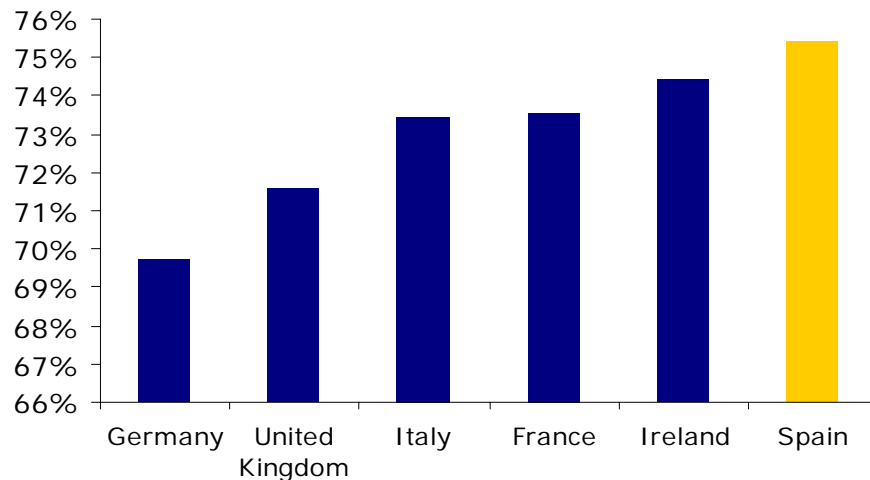
Source: [World Trade Organisation](#).



## While growth potential remains high: employment

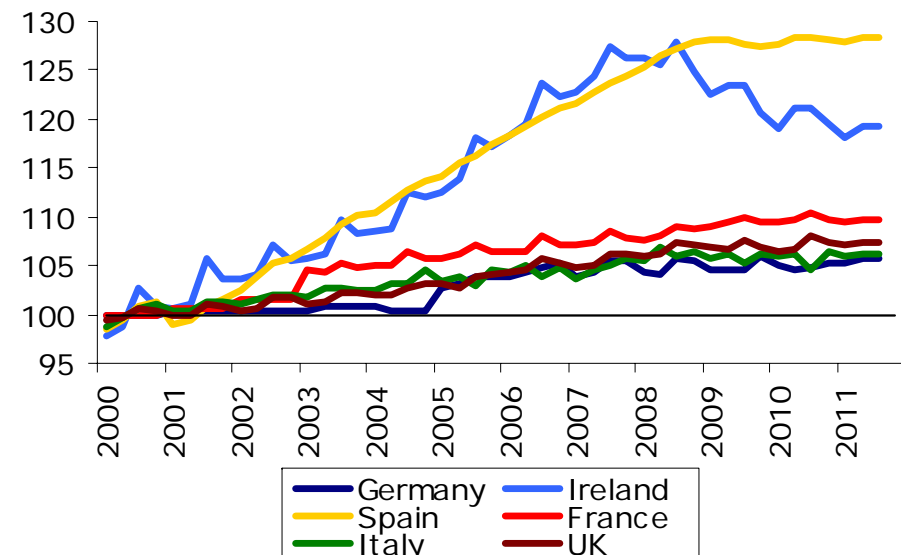
- During the last decade Spain has increased its labour potential enormously
  - Low share of workers above 50 years
  - Active population has raised significantly
  - Educational attainment of the labour force has also increased significantly

Share of workers below 50 years 2011-Q2



Source: [Eurostat](#).

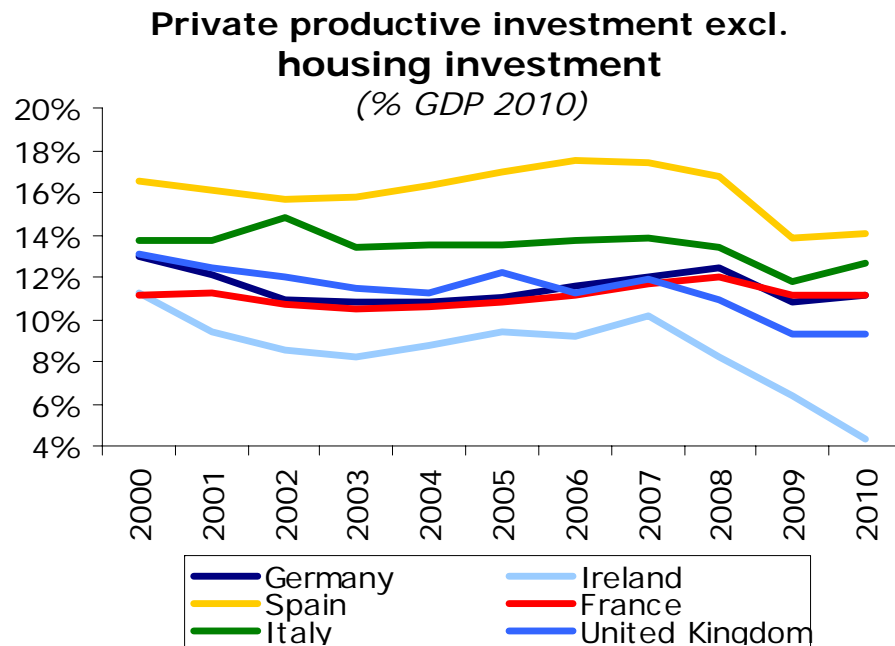
Growth of active population  
(Index 2000-Q1=100)



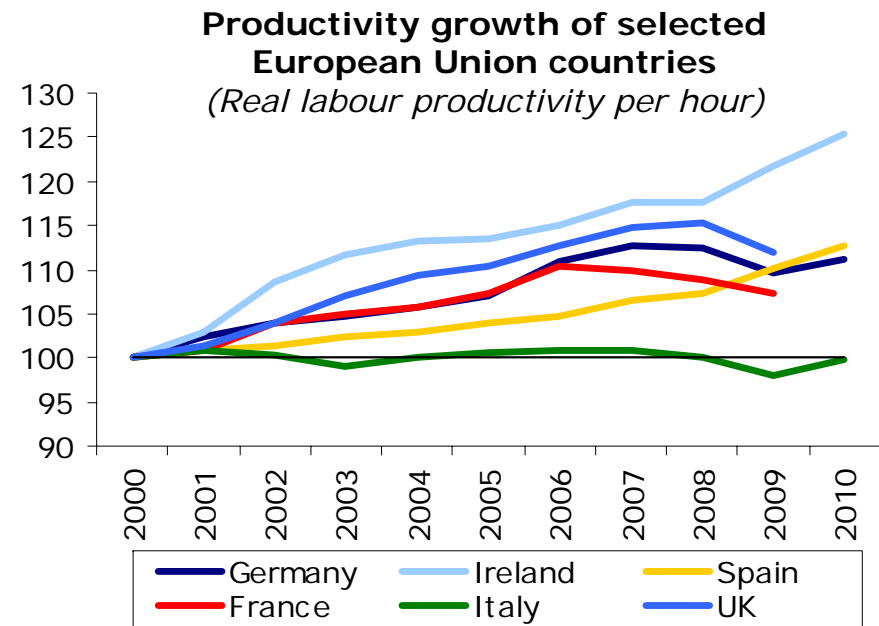
Source: [Eurostat](#).

## Growth based on capital and productivity

- During the last decade Spain has increased its capital labour ratio considerably with private productive investment is well above other European countries
- Productivity measured by hours grew at a similar pace than the Euro Area.
- Recently catching up in levels and the change is structural since construction decrease its weight in the economy



Source: [Eurostat](#).



Source: [Eurostat](#).

## A balanced and sustained growth path for the future

- The combination of structural reforms and the correction of macroeconomic imbalances with the existence of a competitive body of firms and high labour potential will sustain a balanced growth path in the future
- Recent macroeconomic developments show the structural change in the economy
- Despite lower growth for 2011, projections for Spain in the medium-run are in line or above those for the Euro Area

Macroeconomic evolution				
(Year-on-year growth rates, volume measures)				
	2010	2011		
		Q1	Q2	Q3
Final Consumption Expenditure	0.2	0.5	-5.5	-4.2
- Private consumption	-2.4	0.5	-0.3	0.4
- Public Consumption	0.8	0.4	-1.7	-2.3
Gross Fixed Capital Formation	-6.3	-4.9	-5.5	-4.2
Tangible fixed assets	-6.4	-5.3	-5.7	-4.5
Construction	-10.1	-9.3	-8.4	-7.4
Equipment and cultivated assets	5.1	5.6	1.5	2.4
Intangible fixed assets	-4.8	1.2	-3.1	0.8
<b>National demand*</b>	<b>-1.0</b>	<b>-0.7</b>	<b>-1.7</b>	<b>-1.2</b>
Exports of goods and services	9.5	13.9	8.7	8.1
Imports of goods and services	4.9	7.1	-0.7	0.8
<b>External demand*</b>	<b>0.9</b>	<b>1.6</b>	<b>2.5</b>	<b>2.0</b>
<b>GDP</b>	<b>-0.1</b>	<b>0.9</b>	<b>0.8</b>	<b>0.8</b>

Source: *INE*.

\* Contributions to GDP growth

Comparison of growth forecasts						
	Spain			Euro Area		
	IMF	OECD	EC	IMF	OECD	EC
<b>2011</b>	0.8	0.7	0.7	1.6	1.6	1.5
<b>2012</b>	1.1	0.3	0.7	1.1	0.2	0.5
<b>2013</b>	1.8	1.3		1.5	1.4	

Sources: *Ministerio de Economía y Hacienda*.

- **Reform strategy: fiscal, financial and factor markets**
- **Structural and economic rebalancing**
- **Funding and Debt Management**

## Highlights of debt management

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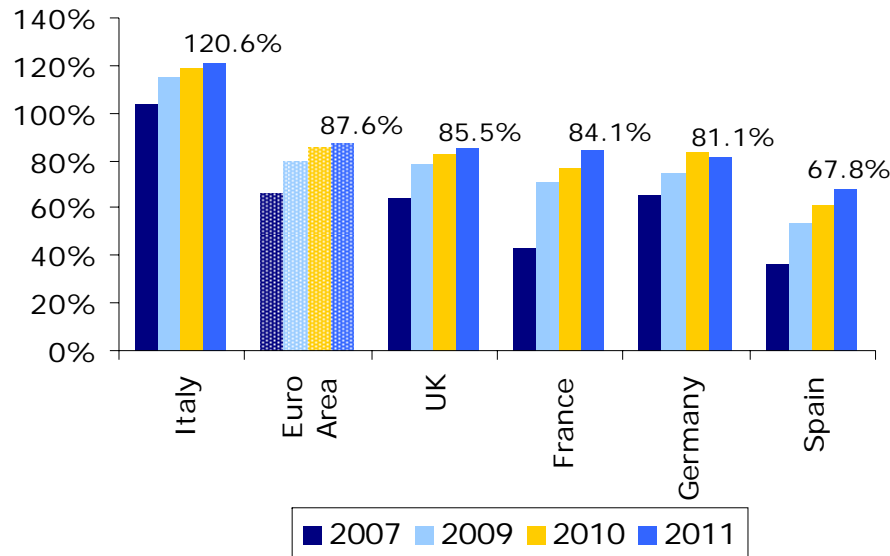
- Substantial reduction of net issuance
- Refinancing risk contained through longer average portfolio maturity
- A solid and diversified investor base, instrumental in difficult times
- Transparency and predictability highly valued by investors



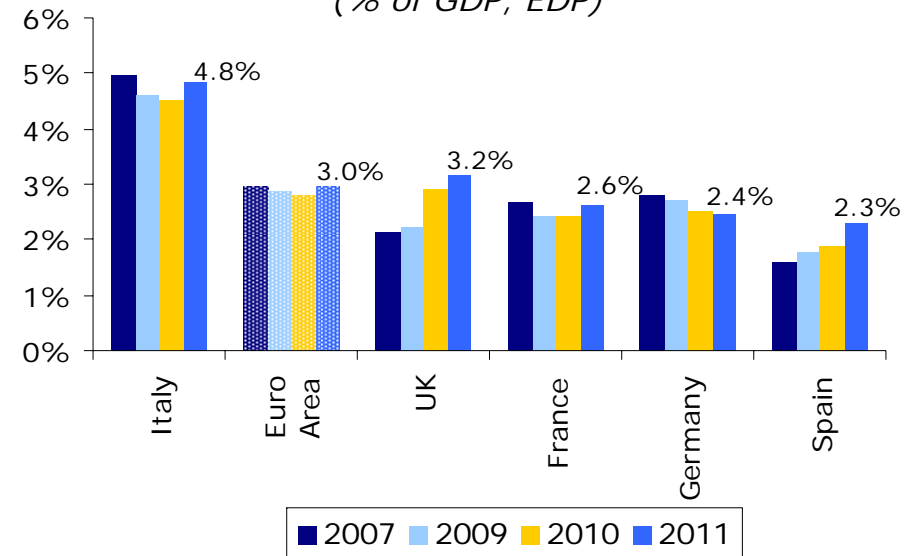
## Debt to GDP well below EU average

- 61% at end 2010 Spain's debt to GDP ratio was 25% lower than the Euro Area average
- A lower debt burden provides resiliency in terms of interest payments and refinancing needs (1.9% of GDP in 2010, projected at 2.3% in 2011)

Debt to GDP ratios



Interest Expenditures  
(% of GDP, EDP)



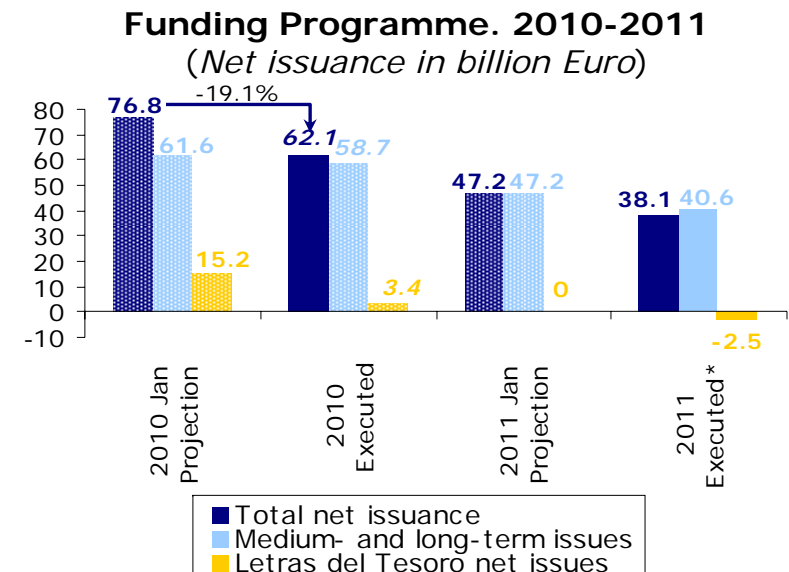
Sources: [Eurostat. EDP Notification Tables October 2011.](#)

## The funding programme in 2011 (I)

- Funding requirement 24% lower than 2010 execution, in accordance with frontloading of fiscal restraint measures
- As of December 1<sup>st</sup>, the gross issuance of medium- and long-term bonds stands at €87.6bn, 93.4% of the initially projected figure

Tesoro funding in 2011 (Billion Euro)	
<b>1: Funding requirement (=Net Issuance)</b>	<b>47.2</b>
2: Redemptions of medium- and long-term bonds	-46.6
3: Net issuance medium- and long-term bonds	47.2
<b>4 = 2 + 3: Gross issuance of medium and long-term bonds</b>	<b>93.8</b>
5: Net increase in T-Bills	0.0
6 = 5 + 3: Net change in outstanding debt	47.2
<b>7: Forecast Outstanding Central Government Debt at end 2011</b>	<b>588.0</b>

Source: [Dirección General del Tesoro y Política Financiera](#).



- New fiscal restraint measures imply lower funding needs than initially projected in the January 2011 programme

## The funding programme in 2011 (II)

- Monthly announcements + potential off-the-run medium and long-term lines announced Friday prior to the auction
- Limit size per line: 16.5 bn € for lines of 10-years and above
- Tesoro Público is open to additional foreign currency issuance
- Private placements/Schuldschein loans

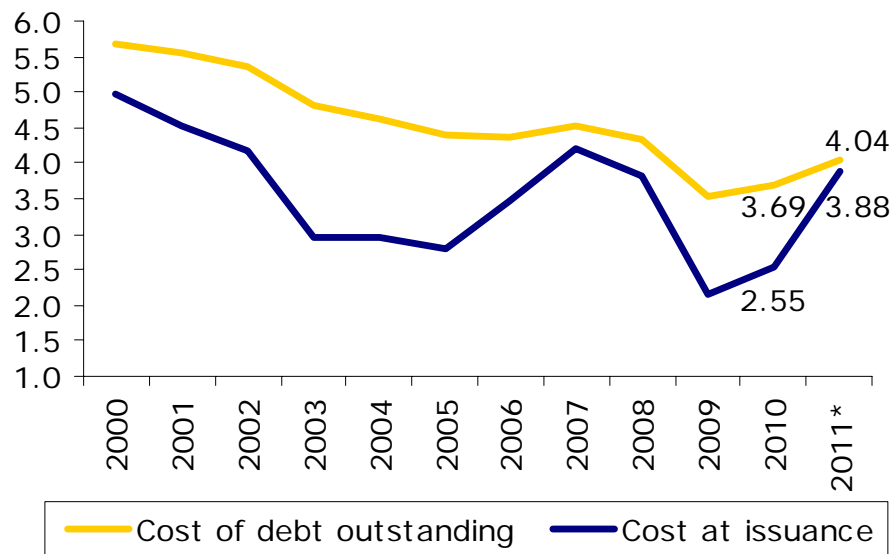
<b>Auctions</b>	<b>Short-term</b>	<b>Letras del Tesoro</b>	
		3- & 6-Month 4th Tuesday of every month	12- & 18-Month 3rd Tuesday of every month
		<i>Yearly calendar</i>	
	<b>Medium- and long-term</b>	<b>Bonos del Estado</b>	<b>Obligaciones del Estado</b>
		3, 5-year benchmarks and off-the-run bonds 1st Thursday of every month	10, 15, 30 -year benchmarks and off-the-run bonds 3rd Thursday of every month
		<i>Monthly announcement on 1st Thursday of every month (Obligaciones of current month and Bonos of next month)</i>	

- Since July 29th: modification of the tax procedure to simplify the obligations of non-resident investors for the actual perception of their interest income free of withholding taxes. Investor identification obligations are eased and broadened in their geographical scope

## Funding execution snapshots

- Above 82% of the funding programme carried out via auctions
- On-going engagement with our investor base to update on the implementation of policy strategy and economic and budgetary developments

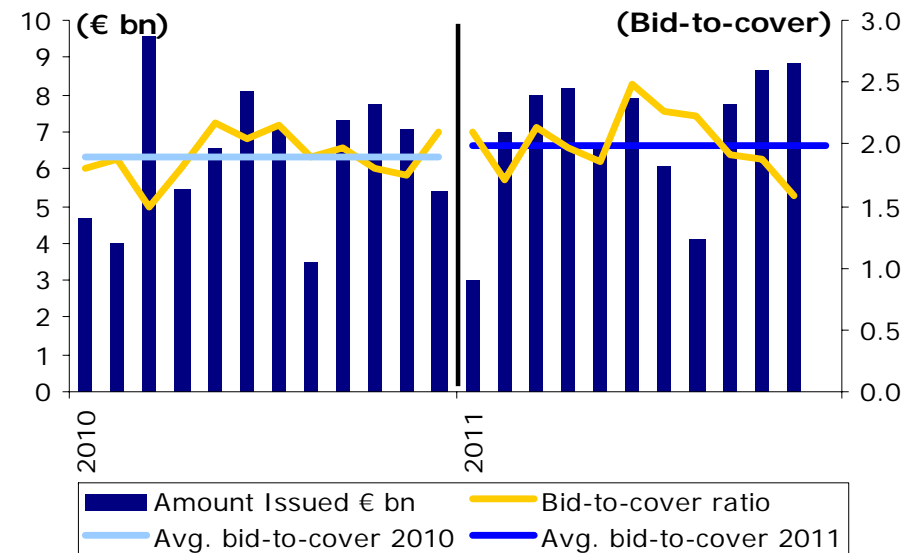
**Cost of debt outstanding and cost at issuance**  
(in percent)



Source: [Dirección General del Tesoro y Política Financiera](#).

\* As of November 30<sup>th</sup> 2011.

**Auctions of Bonos and Obligaciones**  
(up to November 30<sup>th</sup> 2011)



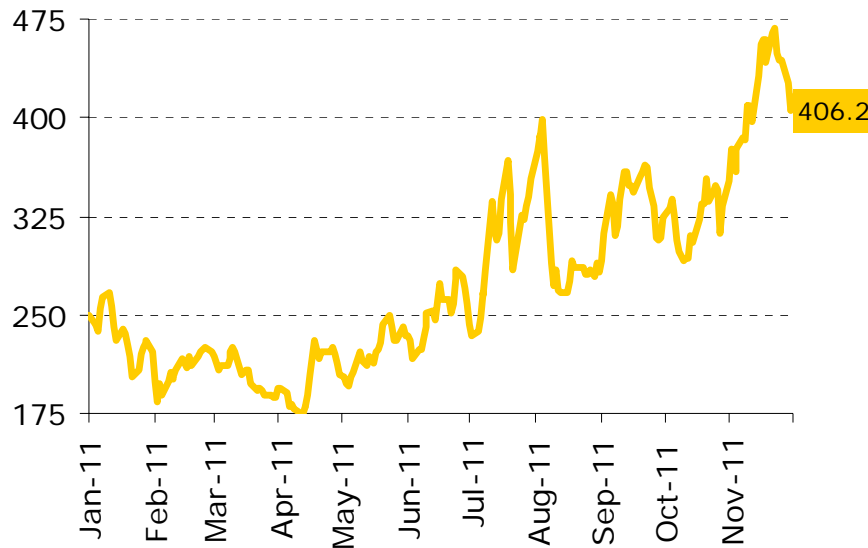
Source: [Dirección General del Tesoro y Política Financiera](#).



## Recent behaviour of spreads and yields

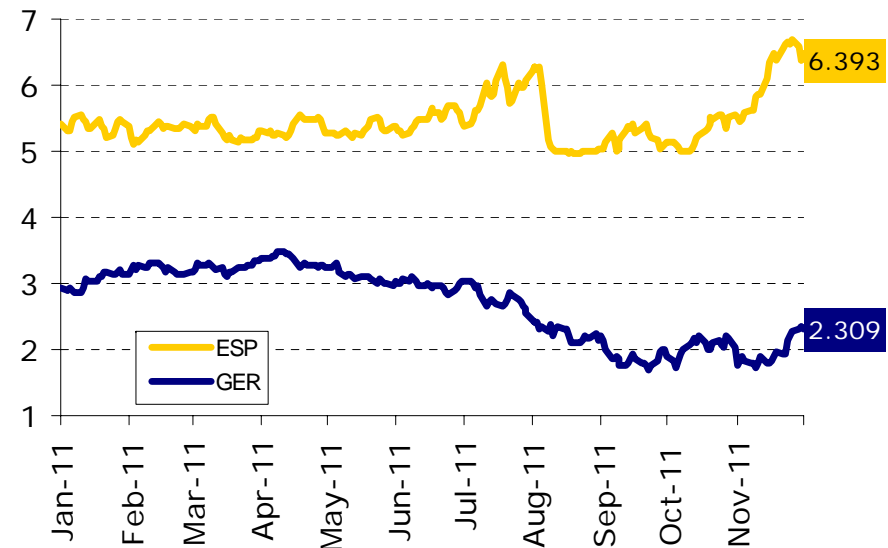
- Spanish spreads have risen throughout the year ... and Bunds have compressed

Spreads Spain vs Germany. 10 Year Bonds  
(in bps)



Source: Bloomberg.

Spain vs Germany. 10 Year Bonds  
(in percent)



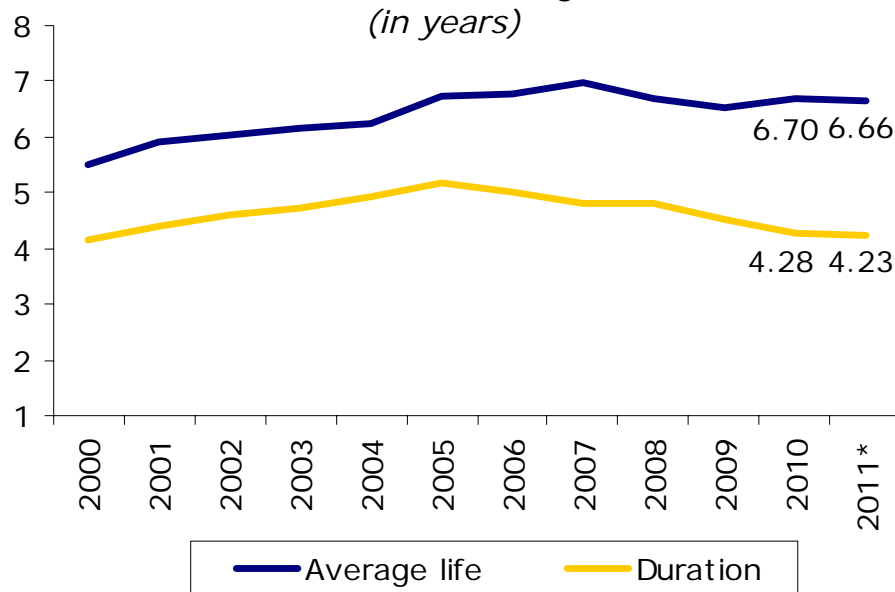
Source: Bloomberg.



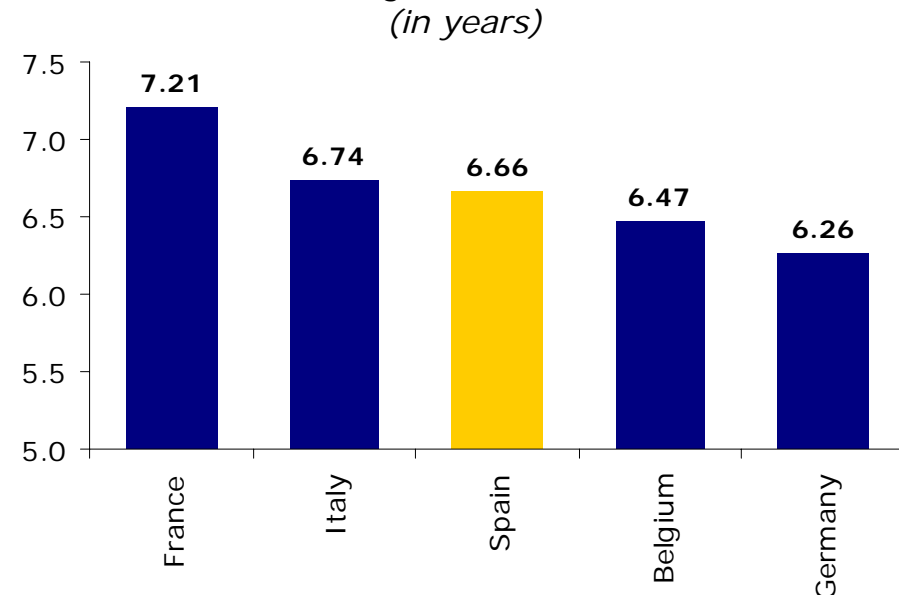
## Lengthening of average life has enabled a prudent debt management

- Average portfolio maturity has increased thanks to a reduced issuance of T-Bills and focus on medium- and long-term supply
- This effort helps reduce refinancing risk, enabling prudent debt management

**Duration & Average Life to Maturity of the Portfolio.**  
**As of November 30<sup>th</sup> 2011**  
 (Letras, Bonos and Obligaciones)



**Average life to Maturity. As of November 30<sup>th</sup> 2011.**  
 (T-Bills and medium and long-term euro-denominated debt, excluding inflation-linked bonds)

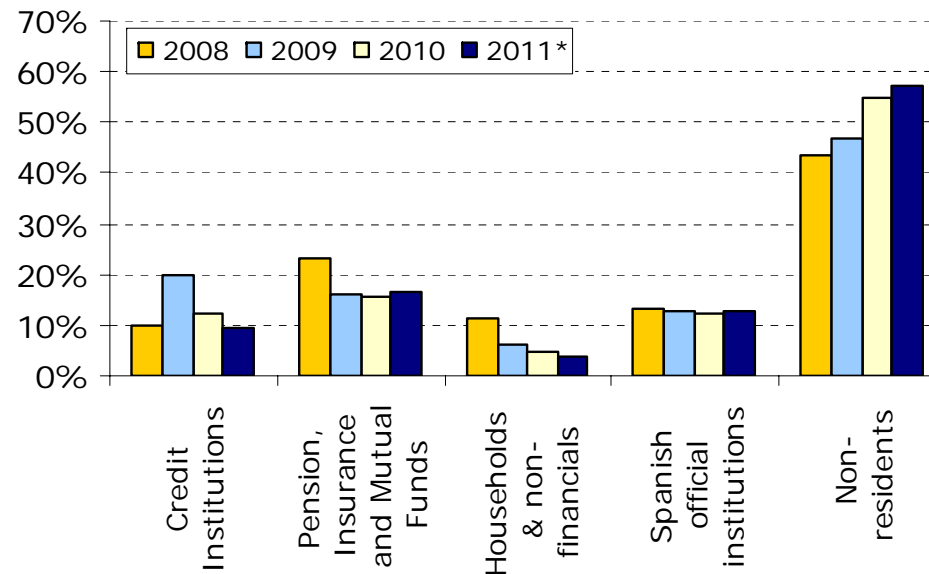


Sources: [Dirección General del Tesoro y Política Financiera](#) and Bloomberg.

## A diversified investor base

- Non-resident investors have been of instrumental importance throughout various periods of uncertainty
- The geographical distribution of holdings of government bonds has remained relatively stable during the last two years

**Total unstripped Government debt by Holder**  
(Registered. In percent of total portfolio)



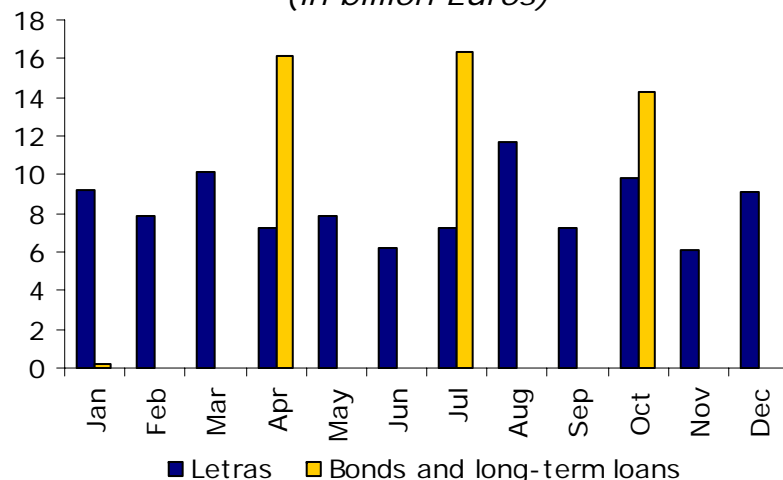
Source: [Dirección General del Tesoro y Política Financiera](#).

\* As of October 31<sup>st</sup> 2011.

## Robust Treasury Management System

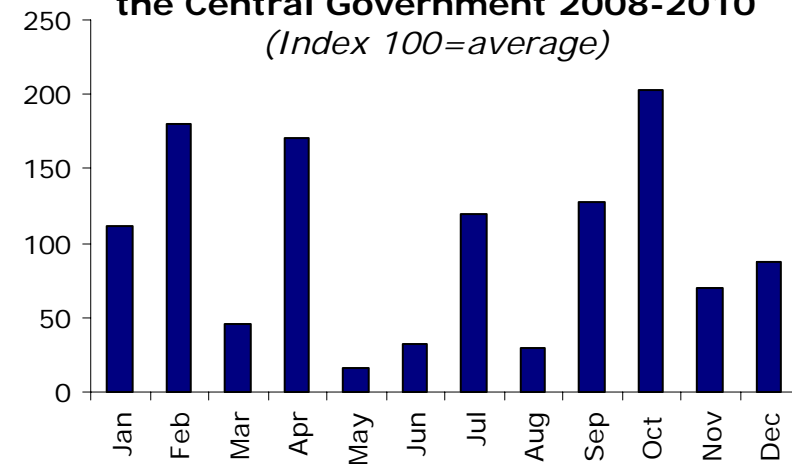
- Redemption dates of medium- and long-term bonds (principal and coupons) match the biggest inflows of tax revenues
- Transparency: regular and publicly available information about budgetary execution, change in cash balances, non resident holdings,...
- Issuance schedule based on very conservative assumptions about budget execution
- Excess liquidity is lent in the money market each month through repo auctions
- Liquidity lines with banks provide an additional buffer

**Monthly maturity structure as of November 30<sup>th</sup> 2011**  
*(in billion Euros)*



Source: [Dirección General del Tesoro y Política Financiera](#).

**Average seasonal index of tax revenues of the Central Government 2008-2010**  
*(Index 100=average)*

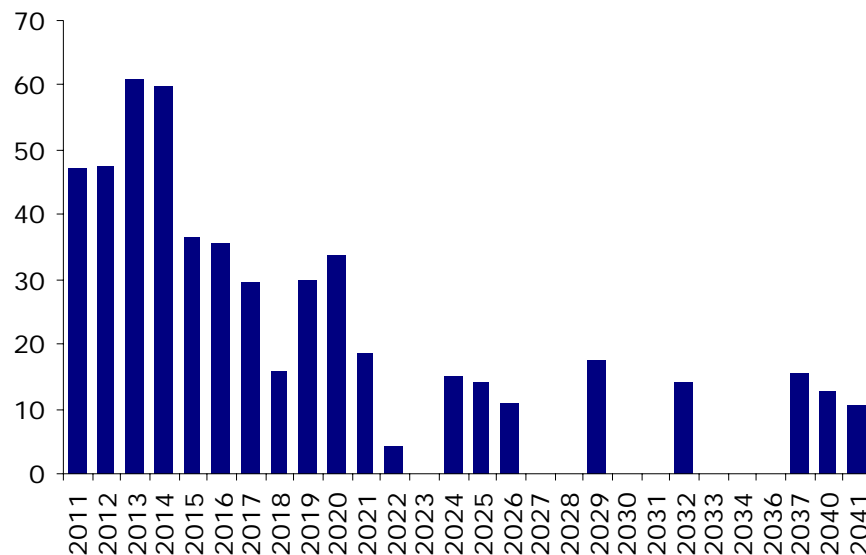


Source: [IGAE](#).

## Risk and refinancing measures

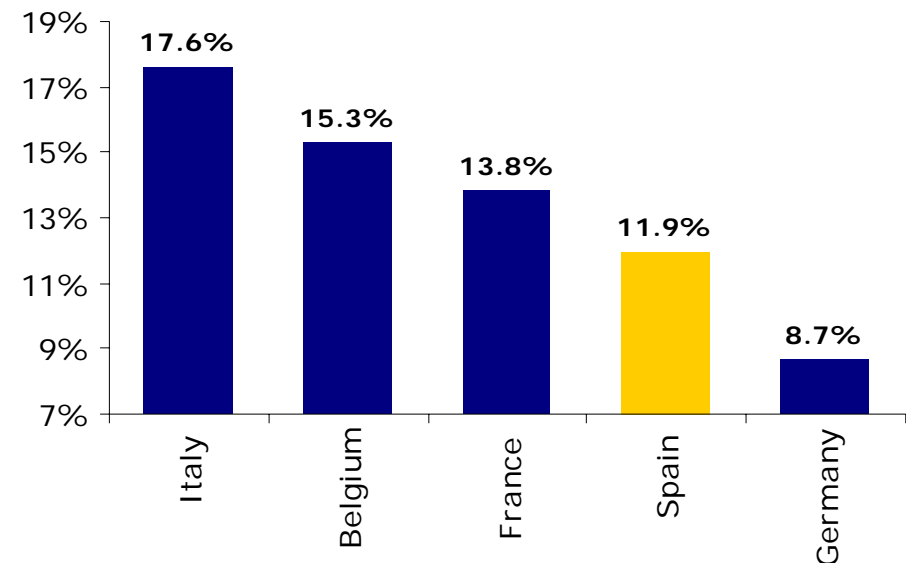
- Refinancing risk remains subdued thanks to a longer average life
- Redemptions of Euro-denominated debt remain well in line with those of peers

**Maturity structure of medium- and long-term bonds**  
(in billion Euros)



Source: [Dirección General del Tesoro y Política Financiera](#).

**Redemptions December 2011 to November 2012**  
(in % of 2011 GDP, Euro-denominated bonds and T-Bills)



Source: [Dirección General del Tesoro y Política Financiera](#) for Spain, Bloomberg for other countries and [EDP Notification Tables October 2011](#), Eurostat.

## More and updated information on the Spanish economy

<http://www.thespanisheconomy.com>



For data sources, please click links below each figure or table

## Thank you for your attention

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