KINGDOM OF SPAIN

Rating Analysis - 10/2/17

*EJR Sen Rating(Curr/Prj) BBB/ BBB
*EJR CP Rating: A2
EJR's 3 yr. Default Probability: 2.0%

Structural reforms in banking, pensions and labor markets have contributed to a robust recovery of the Spanish economy. GDP growth accelerated from -2.9% in 2012 to 3.6% in 2016, largely on account of a steady growth in private consumption and a revival of investment. However, the government deficits have resulted in rising debt levels. Debt-to-GDP was 117% in 2016 compared to 93% in 2012 - not particularly reassuring, especially as it is projected to expand further in the medium term.

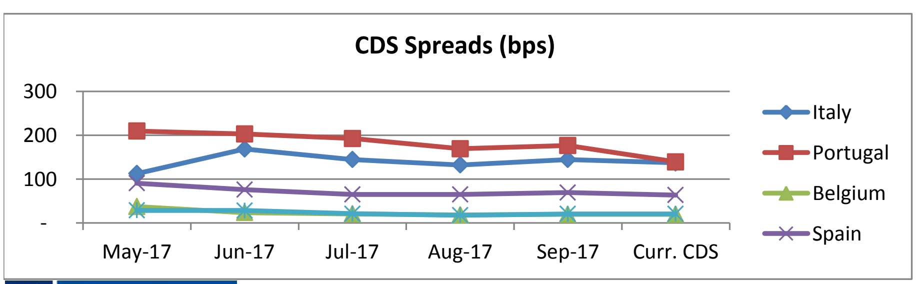
As of early October 2017, the Catalan independence referendum was carried out while the Spanish central government stated it was unconstitutional. Spain may lose approximate 20% of its GDP if Catalonia leaves. The current parliamentary fragmentation is worrisome as it puts at risk the reform agenda that underlies the on-going recovery. On the other hand, the new round of tax cuts that Mr. Mariano Rajoy promised in an effort to court voters might not spur growth. Weakness in the banking sector and high level of unemployment remain sources of downside risk. Downgrading to "BBB". Watch for further moves on the Catalan referendum.

Annual Ratios (source for past results: IMF)

CREDIT POSITION	2014	2015	2016	P2017	P2018	P2019
Debt/ GDP (%)	118.5	116.8	117.2	123.5	129.7	135.7
Govt. Sur/Def to GDP (%)	-6.5	-5.3	-5.0	-4.9	-4.8	-4.7
Adjusted Debt/GDP (%)	118.5	116.8	117.2	123.5	129.7	135.7
Interest Expense/ Taxes (%)	15.6	13.7	12.7	12.8	12.9	13.1
GDP Growth (%)	1.1	3.7	3.6	2.3	2.3	2.3
Foreign Reserves/Debt (%)	2.3	2.7	3.3	3.1	2.9	2.7
Implied Sen. Rating	BBB	BBB+	BBB+	BBB+	BBB	BBB

INDICATIVE CREDIT RATIOS	AA	A	BBB	BB	B	CCC
Debt/ GDP (%)	100.0	115.0	130.0	145.0	170.0	200.0
Govt. Sur/Def to GDP (%)	2.5	0.5	-2.0	-5.0	-8.0	-10.0
Adjusted Debt/GDP (%)	95.0	110.0	125.0	140.0	160.0	190.0
Interest Expense/ Taxes (%)	9.0	12.0	15.0	22.0	26.0	35.0
GDP Growth (%)	3.5	3.0	2.0	1.0	-1.0	-5.0
Foreign Reserves/Debt (%)	3.0	2.5	2.0	1.5	1.0	0.5

PEER RATIOS	Other NRSRO Sen.	Debt as a % GDP	Govt. Surp. Def to GDP (%)	Adjusted Debt/ GDP	Interest Expense/ Taxes %	GDP Growth (%)	Ratio-Implied Rating*
Federal Republic Of Germany	AAA	76.5	0.6	76.5	5.9	3.3	AA-
French Republic	AA	123.5	-3.2	123.5	6.5	1.9	BBB
Kingdom Of Belgium	AA	127.5	-2.5	127.5	9.5	2.8	A-
Republic Of Italy	BBB-	156.4	-2.9	156.4	13.4	1.6	BB+
Portugal Republic	BB+	146.5	-3.3	146.5	16.9	3.0	BBB

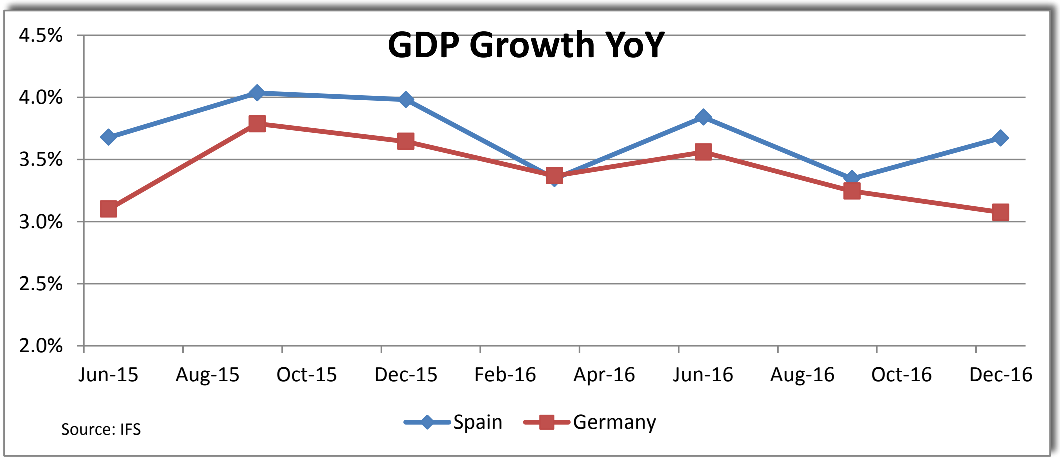


Country	CDS
Italy	137
Portugal	139
Belgium	20
Spain	64
France	21

Economic Growth

Spain has been leading other EU countries in growth since 2015, with nominal GDP expanding at 3.7% for the fourth quarter of 2016, surpassing that of Germany. A key driver was the robust recovery of private consumption, followed by growth in investment. On the other hand, government spending has reported a minimal increase, suggesting that public debt is contained.

Another factor to consider is the implementation of structural reforms, which has been favorably contributing to growth, but is likely to be undermined if the current political deadlock persists.



Fiscal Policy

Spain's deficit-to-GDP of 4.99% is not particularly comforting. As can be seen from the chart to the right, Spain has the worst deficit compared to its peers. However, improvements have been shown as the budget deficit narrowed from 10.6% of GDP in 2012 to 5.0% in 2016. Government revenue is growing at an annualized rate of 1.9% from 2012 to 2016, whereas expenditure is decreasing at 1.2% for the same period, as a result of the recovery of the private sector that necessitates minimal fiscal stimulus and lowers unemployment.

	Surplus-to-GDP (%)	Debt-to-GDP (%)	5 Yr. CDS Spreads
Spain	-4.99	117.22	63.51
Germany	0.65	76.47	12.84
France	-3.25	123.55	20.54
Belgium	-2.52	127.52	19.73
Italy	-2.94	156.39	137.12
Portugal	-3.33	146.46	139.40

Sources: Thomson Reuters and IFS

Unemployment

Unemployment has been a scourge on the country. The 2016 statistics came in at 19.6%, which, despite signs of improvement as compared to 22.1% in 2015, is still the second highest in the Eurozone. We expect several factors to continue to alleviate the unemployment condition, including the growth of the services sectors and the potential tax cuts promised by Marioano Rajoy, assuming his re-election.

Unemployment (%)	2015	2016
Spain	22.10	19.60
Germany	4.60	4.10
France	10.40	10.06
Belgium	8.50	7.83
Italy	11.89	11.68
Portugal	12.43	11.05

Source: Intl. Finance Statistics

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Banking Sector

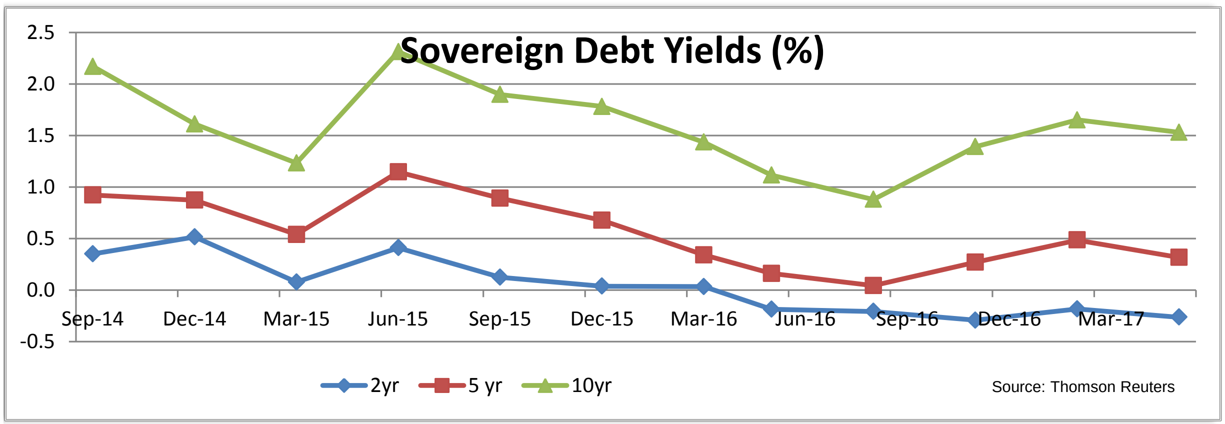
The banking sector required a bailout of $100 billion in 2012, but has coped well since. According to an ECB review in 2014, capital and earnings are improving along with the asset quality. However, given the significant size of the banks' balance sheet (top five account for 209% of GDP), substantial risks remain in the sector concerning profitability pressures and high (albeit declining) level of non-performing loans.

Bank Assets (billions of local currency)

	Assets	Mkt Cap/ Assets %
BANCO SANTANDER	1266.30	7.66
BBVA	631.94	9.37
BANESTO SA	102.42	0.00
BANCO POPULAR	161.46	6.18
BANCO SABADELL	163.35	7.16
Total	2,325.5	
EJR's est. of cap shortfall at 10% of assets less market cap		54.6
Spain's GDP		1,113.9

Funding Costs

As can been seen in the graph below, the short-term bond yields gradually declined while the yields of longer terms fluctuated since 2014. 2-year sovereign debt yield dropped below 0 and remained negative after March, 2016. Yields may rise in the next couple of months due to the monetary policies of EU, which may raise funding costs for the Spanish government.



Ease of Doing Business

Major factors for growing the economy are the ease of doing business and the economic freedom; although not the sole factor for determining economic growth, a country which makes it easy for businesses to operate and provides a reasonably free environment to conduct business has a good chance for growth. The chart on the right indicates that with an overall rank of 32 (1 is best, 189 worst) is above average.

The World Bank's Doing Business Survey*

	2017 Rank	2016 Rank	Change in Rank
Overall Country Rank:	**32**	**33**	**1**
Scores:			
Starting a Business	85	82	-3
Construction Permits	113	101	-12
Getting Electricity	78	74	-4
Registering Property	50	49	-1
Getting Credit	62	59	-3
Protecting Investors	32	29	-3
Paying Taxes	37	60	23
Trading Across Borders	1	1	0
Enforcing Contracts	29	39	10
Resolving Insolvency	18	25	7

* Based on a scale of 1 to 189 with 1 being the highest ranking.

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Economic Freedom

As can be seen below, Spain is above average in its overall rank of 63.6 for Economic Freedom with 100 being best.

Heritage Foundation 2017 Index of Economic Freedom
World Rank 63.6*

	2017 Rank**	2016 Rank	Change in Rank	World Avg.
Property Rights	71.2	70.0	1.2	52.2
Government Integrity	57.2	60.0	-2.8	42.4
Judical Effectiveness	53.9	N/A	N/A	44.4
Tax Burden	62.5	58.3	4.2	77.3
Gov't Spending	41.4	41.1	0.3	63.0
Fiscal Health	26.9	N/A	N/A	66.3
Business Freedom	66.9	76.0	-9.1	64.8
Labor Freedom	55.3	51.7	3.6	59.4
Monetary Freedom	85.5	84.7	0.8	76.3
Trade Freedom	87.0	88.0	-1.0	75.9

*Based on a scale of 1-100 with 100 being the highest ranking.
**The ten economic freedoms are based on a scale of 0 (least free) to 100 (most free).
Source: The Heritage Foundation

Credit Quality Driver: Taxes Growth:
KINGDOM OF SPAIN has grown its taxes at 1.7% per annum in the last fiscal year which is more than the average for its peers. We expect tax revenues will grow approximately 1.5% per annum over the next couple of years and 1.5% per annum for the next couple of years thereafter.

Credit Quality Driver: Total Revenue Growth:
KINGDOM OF SPAIN's total revenue growth has been slightly more than its peers and we assumed 1.5% growth in total revenue over the next two years, provided Catalonia did not succeed.

	Peer	Issuer	Assumptions	
Income Statement	**Median**	**Avg.**	**Yr 1&2**	**Yr 3,4,5**
Taxes Growth%	1.6	1.7	**1.5**	**1.5**
Social Contributions Growth %	1.4	3.1	**2.5**	**2.5**
Grant Revenue Growth %	0.0	NMF		
Other Revenue Growth %	0.0	NMF		
Other Operating Income Growth%	0.0	(5.1)	**(5.1)**	**(5.1)**
Total Revenue Growth%	1.4	1.5	**1.5**	**1.3**
Compensation of Employees Growth%	2.1	1.9	**1.9**	**1.9**
Use of Goods & Services Growth%	1.1	(2.1)		
Social Benefits Growth%	1.8	2.0	**2.0**	**2.0**
Subsidies Growth%	0.2	(8.0)		
Other Expenses Growth%	0.0			
Interest Expense	1.8	2.4	**2.5**	**2.7**
Currency and Deposits (asset) Growth%	0.0	0.0		
Securities other than Shares LT (asset) Growth%	0.0	0.0		
Loans (asset) Growth%	0.5	(1.9)	**(1.9)**	**(1.9)**
Shares and Other Equity (asset) Growth%	2.7	2.2	**2.2**	**2.2**
Insurance Technical Reserves (asset) Growth%	(1.3)	0.0		
Financial Derivatives (asset) Growth%	0.0	(7.2)	**(7.2)**	**(7.2)**
Other Accounts Receivable LT Growth%	(1.7)	(5.3)	**(5.3)**	**(5.3)**
Monetary Gold and SDR's Growth %	0.0	0.0	**5.0**	**5.0**
Other Assets Growth%	0.0	0.0		
Other Accounts Payable Growth%	0.0			
Currency & Deposits (liability) Growth%	1.2	4.7	**4.7**	**4.7**
Securities Other than Shares (liability) Growth%	3.7	6.2	**4.3**	**4.3**
Loans (liability) Growth%	(1.4)	(6.7)	**0.5**	**0.5**
Insurance Technical Reserves (liability) Growth%	0.0	(100.0)		
Financial Derivatives (liability) Growth%	0.0	0.0		
Additional ST debt (1st year)(millions EUR)	0.0	0.0		

ANNUAL INCOME STATEMENTS

Below are KINGDOM OF SPAIN's annual income statements with the projected years based on the assumptions listed on page 5.

ANNUAL REVENUE AND EXPENSE STATEMENT
(MILLIONS EUR)

	2013	2014	2015	2016	P2017	P2018
Taxes	225,283	230,915	243,036	247,160	250,867	254,630
Social Contributions	128,217	130,052	132,290	136,341	139,750	143,243
Grant Revenue						
Other Revenue						
Other Operating Income	42,097	42,464	40,213	38,171	38,171	38,171
Total Revenue	395,597	403,431	415,539	421,672	428,788	436,045
Compensation of Employees	114,711	115,206	119,125	121,431	123,782	126,178
Use of Goods & Services	54,736	55,133	57,142	55,949	55,949	55,949
Social Benefits	198,967	198,720	198,777	202,841	206,988	211,220
Subsidies	10,853	11,430	12,470	11,467	11,468	11,469
Other Expenses				26,683	26,683	26,683
Grant Expense						
Depreciation	27,832	27,783	27,588	27,572	27,572	27,572
Total Expenses excluding interest	436,020	434,304	438,840	445,943	452,442	459,071
Operating Surplus/Shortfall	-40,423	-30,873	-23,301	-24,271	-23,654	-23,026
Interest Expense	35,617	36,026	33,227	31,358	32,142	32,945
Net Operating Balance	-76,040	-66,899	-56,528	-55,629	-55,796	-55,972

*EJR Sen Rating(Curr/Prj) BBB/ BBB
*EJR CP Rating: A2
EJR's 3 yr. Default Probability: 2.0%

ANNUAL BALANCE SHEETS

Below are KINGDOM OF SPAIN's balance sheets with the projected years based on the assumptions listed on page 5.

ANNUAL BALANCE SHEETS
(MILLIONS EUR)

Base Case						
ASSETS	2013	2014	2015	2016	P2017	P2018
Currency and Deposits (asset)						
Securities other than Shares LT (asset)	13,953	8,501				
Loans (asset)	60,568	61,422	58,796	57,702	56,628	55,575
Shares and Other Equity (asset)	149,855	154,519	163,520	167,136	170,832	174,610
Insurance Technical Reserves (asset)					0	0
Financial Derivatives (asset)	72,709		85,453	79,287	73,566	68,258
Other Accounts Receivable LT	71,823	71,823	66,471	62,963	59,640	56,493
Monetary Gold and SDR's						
Other Assets					2,968	2,968
Additional Assets		83,924	3,833	2,968		
Total Financial Assets	368,908	380,189	378,073	370,056	363,634	357,903

LIABILITIES						
Other Accounts Payable						
Currency & Deposits (liability)	3,696	3,847	4,056	4,247	4,247	4,247
Securities Other than Shares (liability)	807,072	951,182	1,000,570	1,062,733	1,108,951	1,157,178
Loans (liability)	214,224	216,087	196,268	183,094	238,890	294,862
Insurance Technical Reserves (liability)			208			
Financial Derivatives (liability)						
Other Liabilities	59,290	58,053	55,771	55,619	55,619	55,619
Liabilities	1,084,282	1,229,169	1,256,873	1,305,693	1,355,067	1,405,307
Net Financial Worth	-715,374	-848,980	-878,800	-935,637	-991,433	-1,047,405
Total Liabilities & Equity	368,908	380,189	378,073	370,056	363,634	357,903

Comments on the Difference between the Model and Assigned Rating

SEC Rule 17g-7(a) Disclosure

Below are the disclosures as required by Paragraph (a) of Rule 17g-7.

1. The symbol in the rating scale used to denote the credit rating categories and notches within categories and the identity of the obligor, security, or money market instrument as required by Paragraph (a)(1)(ii)(A) of Rule 17g-7:
For the issuer KINGDOM OF SPAIN with the ticker of 1841z SM we have assigned the senior unsecured rating of BBB. There are three notches in our rating categories (e.g., A-, A, and A+) other than those deep into speculative grade; for CC, C, and D there are no notches.

2. The version of the procedure or methodology used to determine the credit rating as required by Paragraph (a)(1)(ii)(B) of Rule 17g-7:
We are using the methodology available in our Form NRSRO Exhibit #2 dated May 10, 2015 available via egan-jones.com under the tab at the bottom of the page "Methodologies".

3. The main assumptions and principles used in constructing the procedures and methodologies used to determine the credit rating as required by Paragraph (a)(1)(ii)(C) of Rule 17g-7:
The credit rating assigned reflects our judgement regarding the future credit quality of the issuer. Regarding the specific assumptions used, please refer to page 3 of this Rating Analysis Report.

4. The potential limitations of the credit rating as required by Paragraph (a)(1)(ii)(D) of Rule 17g-7:
Our rating pertains solely to our view of current and prospective credit quality. Our rating does not address pricing, liquidity, or other risks associated with holding investments in the issuer.

5. Information on the uncertainty of the credit rating as required by Paragraph (a)(1)(ii)(E) of Rule 17g-7:
Our rating is dependant on numerous factors including the reliability, accuracy, and quality of the data relied used in determining the credit rating. The data is sourced from publicly-available 10Q and 10K statements, quarterly reports, 8K filings, earnings reports, and other similar sources. In some cases, the information is limited because of issues such as short operating histories, the lack of reported data, a delay in reporting data, restatements, inaccurate accounting, and other issues. Such shortcomings are not always readily apparent. EJR aims to identify such shortcomings and make adjustments using its best judgement.

6. Whether and to what extent third-party due diligence services have been used in taking the rating action as required by Paragraph (a)(1)(ii)(F) of Rule 17g-7:
EJR does not utilize third-party due diligence services.

7. How servicer or remittance reports were used, and with what frequency, to conduct surveillance of the credit rating as required by Paragraph (a)(1)(ii)(G) of Rule 17g-7:
Servicer or remittance reports normally pertain to structured finance issuers; this report does not pertain to a structured finance issuer (EJR is not an NRSRO for structured finance or sovereigns/ municipal issuers). Regarding surveillance, the minimum time period for corporation issuers is normally one year.

8. A description of the data that were relied upon for the purpose of determining the credit rating as required by Paragraph (a)(1)(ii)(H) of Rule 17g-7:
EJR uses 10Q and 10K statements, quarterly reports, 8K filings, earnings reports, and other similar sources for ratings on publicly-traded issuers. In the case of private issuers, EJR relies on information provided mainly by issuers.

9. A statement containing an overall assessment of the quality of information available and considered in the credit rating as required by Paragraph (a)(1)(ii)(I) of Rule 17g-7: The information is generally high quality and readily avail.

10. Information relating to conflicts of interest as required by Paragraph (a)(1)(ii)(J) of Rule 17g-7:
This rating is unsolicited.

11. An explanation or measure of the potential volatility of the credit rating as required by Paragraph (a)(1)(ii)(K) of Rule 17g-7:
Our rating aims to assess the probability of the payment of obligations in full and on-time. Factors which affect such probability, and in turn our rating, include changes in the operating performance of the issuer, changes in capital structure, and merger and acquisition events.

12. Information on the content of the credit rating as required by Paragraph (a)(1)(ii)(L) of Rule 17g-7:
Regarding the historical performance of the credit rating, our rating transition matrix is available in our Form NRSRO, exhibit 1. The expected probability of default and the expected loss in the event of default is listed on the first page of this report.

13. Information on the sensitivity of the credit rating to assumptions as required by Paragraph (a)(1)(ii)(M) of Rule 17g-7:
Below is a summary of the impact of the 5 assumptions which independently would have the greatest impact on our "ratio-implied rating":

	Assumptions			Resulting Ratio-Implied Rating		
	Base	Optimistic	Pessimistic	Base	Optimistic	Pessimistic
Taxes Growth%	1.5	5.5	(2.5)	BBB	BBB	BBB
Social Contributions Growth %	2.5	5.5	(0.5)	BBB	BBB	BBB
Other Revenue Growth %		3.0	(3.0)	BBB	BBB	BBB
Total Revenue Growth%	1.5	3.5	(0.5)	BBB	BBB	BBB
Monetary Gold and SDR's Growth %	5.0	7.0	3.0	BBB	BBB	BBB

14. If the credit rating is assigned to an asset-backed security, a description of: (i) the representations, warranties, and enforcement mechanisms available to investors; and (ii) how they differ from the representations, warranties, and enforcement mechanisms in issuances of similar securities, as required by Paragraph (a)(1)(ii)(N) of Rule 17g-7:
This credit rating is not assigned to an asset-backed security.

ATTESTATION FORM

In compliance with the US Securities and Exchange Commission (SEC) Rule 17g-7(a), the Egan-Jones analyst who published the report is responsible for the rating action and to the best knowledge of the person:

1) No part of the credit rating was influenced by any other business activities,
2) The credit rating was based solely upon the merits of the obligor, security, or money market instrument being rated, and
3) The credit rating was an independent evaluation of the credit risk of the obligor, security, or money market instrument.

Analyst Signature: **Today's Date**

Mike Huang cac ……………………………………………………… October 02, 2017 ………………………………………

Mike Huang
Rating Analyst

Reviewer Signature: **Today's Date**

Caroline Ding ……………………………………………………… October 02, 2017 ………………………………………

Caroline Ding
Rating Analyst

Sovereign Rating Methodology (Non-NRSRO)

Scope and Limitations: Sovereign Issuer Credit Quality Ratings (CQR) are a forward-looking assessment of a sovereign's capacity and willingness to honor its existing and future obligations in full and on time. Sovereigns are assigned two CQRs: a Local-Currency CQR, which reflects the likelihood of default on debt issued and payable in the currency of the sovereign, and a Foreign-Currency CQR, which is an assessment of the credit risk associated with debt issued and payable in foreign currencies.

Key Rating Drivers: EJR's approach to sovereign risk analysis is a synthesis of quantitative and qualitative judgments. The quantitative factors EJR uses are:

- Debt in relation to GDP.
- Surplus or deficit in relation to GDP.
- Debt plus potential under-funding of major banks in relation to GDP.
- Interest expense in relation to taxes.
- GDP growth.
- Foreign reserves in relation to debt.

Debt levels for many sovereign issuers have increased at an accelerating rate over the past decade, affecting implied ratings. EJR also considers unemployment levels and funding costs. EJR recognizes that no model can fully capture all the relevant influences on sovereign creditworthiness, meaning that the its sovereign ratings can and do differ from those implied by the rating model. Some of the qualitative factors that impact its ultimate assessment of credit quality include the flexibility, stability and overall strength of the economy, efficiency of tax collection, acceptance of contract law, ease of doing business, trade balances, prospects for future growth and health and monetary policy, and economic freedom. These subjective and dynamic qualitative issues are not captured by the model but affect sovereign ratings

For additional information, please see Exhibit 2: Methodologies in EJR's Form NRSRO.