

THE BROOKINGS INSTITUTION

REVIVING GROWTH IN SPAIN AND THE EURO AREA

Washington, D.C.

Friday, February 24, 2012

PARTICIPANTS:

Introduction and Moderator:

KEMAL DERVIS
Vice President and Director, Global Economy and Development
The Brookings Institution

Featured Speaker:

LUIS DE GUINDOS
Minister of Economy and Competitiveness
Kingdom of Spain

* * * * *

PROCEEDINGS

MR. DERVIS: Good morning, everyone. Thank you very much. We have a full house and a wonderful guest, a guest who is in the eye of the storm but who is handling the ship very strongly already.

Welcome, Your Excellency, Minister Luis de Guindos. The minister has been minister since December 22, just before Christmas, and is in charge of the Spanish economic program and of course is participating in the design of the overall European reform programs. He has had vast international experience and national experience. He was already Deputy Minister from 2002 to 2004, Vice Chairman of the E.U. Economic Policy Committee, Chief Executive Officer at A.B. Assosoros and also Chief Executive of Lehman Brothers Spain among many other things. As you can see, minister, despite very short notice we have a full house and people are scrambling for seats. There is huge interest in what's happening in Spain. There is also a lot of sympathy for you personally and for the efforts of Spain. And it's at a time that is critical for the European economy and for the world economy. The package that was agreed last Monday I think on Greece has been another major step, but these are steps and we are all wondering how it's all going to add up. I think the basic reactions from the markets have been quite positive. As you know, the euro as a currency and obviously the dollar has reached

their strongest points in the last few months and I think this is an indication that there is confidence that Europe is tackling its problem and the Euro Zone is tackling its problems.

But there still is this big issue of short-term management of the crisis, liquidity for the banks trying to control the immediate dangers, versus the longer-term growth agenda for Europe because I think most economists agree or most observers agree that unless growth can start again in a significant way in the Southern European countries, the control of the debt and the financial measures are going to be temporary measures and not measures that really solve the problem. In that sense I think it's particularly interesting that your title is Minister for Economy and Competitiveness which maybe is a signal that the growth and competitive agenda is as important as the pure short-term stabilization and banking sector agenda.

I remember the Managing Director of the IMF Christine Lagarde in August I think it was had a speech which was reported in the "Financial Times" which essentially had a key sentence saying, "Markets don't like debt, but they dislike lack of growth even more," and of course indebtedness ratios are always ratios of the debt as the numerator to the GDP as the denominator and what happens to them depends on both.

With this let me again welcome you all. Thank you for

joining us and it's great pleasure and honor over the floor to Minister de Guindos.

MINISTER DE GUINDOS: Let me start if I may by thanking Brookings for inviting me to share some views on the Spanish economy and the European economy. You know these are not easy times as you can imagine. I am minister of economy in the middle. I don't know if this is in the eye of the storm, but this is in the middle of the worst destabilization that we had over the last five decades in the world economy and especially in Europe. You know these are interesting and challenging times and I think that they are going to be quite demanding, and especially quite demanding for the people responsible for implementing the economic policy of the different countries.

I'm going to make and to put forward and to start with some remarks on the European situation. Last Monday we approved the second bailout program of Greece as you have mentioned before. This has been an important step forward because the alternative was much worse -- I think that in Europe we are going to take important measures in order to try and to put order in the crisis that we are living right now. This is not going to be easy, I have to recognize a priori, and afterwards I will make also remarks on the Spanish economy and the situation of the Spanish economy and the steps that the new government that arrived in

office 2 months ago has been trying to tackle the extremely difficult situation that we have found in the Spanish economy.

First of all, with respect to Europe, first of all, I think that we have some good news. Good news because we closed as I have mentioned before the bailout program of Greece. I think that the alternative as I have said was much, much worse. Defaults as divorces are always disorderly and we have avoided in this case a disorderly default. I think an important point is that we are gaining time with respect to Greece and simultaneously I think that we are giving time to the Greek government to implement the measures that they need to return to the markets once this program has been consumed.

But the remark that I would like to make and the idea that I would like to convey to you with respect to Greece is that the problem for Greece is not only a financial or economic problem. It's much more a political problem. It's a problem about the credibility of the government to deliver, to deliver the measures in terms of fiscal adjustment, in terms of structural reform that the Greek economy needs in order to be back to growth and to be on track again in terms of fiscal consolidation. If Greece and the Greek government and the Greek population do not have these measures in place and the markets have not the perception and do not obtain the perception that Greece will be able to finance itself in the

markets in the future, I think that is going to be quite useless. So this is the starting point. We have saved Greece. We have gained some time. But at the end of the day, what we are doing with Greece will be assessed and will be valued in terms of the Greek economy to be on track and to be growing again. If the Greek economy is not competitive, then we'll have a problem as you have mentioned before.

There are some remarks on some I could say ramifications of the Greek situation that I think are worthwhile to stress and to review. The first one is that Greece has a small economy. It's something below 2 percent of the GDP of the Euro Zone. The first question that comes into our heads is how an economy that is so small has created so many problems in terms of the Euro Zone, the Euro Zone that is perhaps the largest and wealthiest economic area of the world? Here the point that I would like to stress that we had some governance in the institutional framework of the Euro Zone, some evident -- that I think we will have to modify. We had a monetary union but we had a monetary union with a fiscal union even with our economy policy union and I think that this is something that we will have to modify in the future. We have started to modify it and I think that we have learned our mistakes.

I was Deputy Minister of Finance of Spain in 2003 and in 2003 Germany and France breached the rules of the union and I think that

we are paying the consequences of that. If the countries of reference, the benchmarks of the union, the anchors of the European Union breached the rules, how are we going to demand fiscal consolidation, fiscal discipline to a country like Greece? I think that now we are paying the consequences of this decision that was taken in 2003 because we modified the stability and growth pact and this modification was in favor of the large countries and when you bias the rules in the middle of the game, then you have to take into consideration and you have to pay the consequences of that and I think that now we are paying the consequences of that, but this is something that especially the German government has learned in the past.

Simultaneously to give you news about the Euro Zone, I think there are some positive elements that we have to bear in mind. The first one I think is that we have to important governments of the Euro Zone that I think that now have serious governments in place. The situation of Italy and the situation of Spain has been modified and I think that in terms of the political framework, I think that this is important. Italy is the third economy of the Euro Zone and Spain is the fourth economy of the Euro Zone and now they count and they count on the future policies that we'll have to pursue in the future. With orthodox governments, with governments willing to deliver, I think that the balance of power in the Euro

Zone will be modified and will give rise to different possibilities in the future with respect to the alliances and the policies that can be implemented in the future.

Thirdly, if you'll allow me to say, you are fully aware that we have a mild recession in Europe and I think that the attention of the policymakers is changing and is switching from austerity to growth. We have made in some cases wholehearted efforts to reduce and to rein in deficits, to reduce the public debt and these efforts have given in certain areas in certain countries to a mild recession as I have said. Now I think that we have to be much more preoccupied about pro-growth policies. As you have mentioned, fiscal consolidation per se is not a policy in itself. Fiscal consolidation makes sense especially if you are simultaneously applying other kinds of policies that give rise to much more potential growth in the medium term. And the impression that I have now is that in Brussels and in the European institutions we have to pay and we are going to much more attention to pro-growth policies in that regard.

This is with respect to Europe and the Euro Zone debt crisis. Let me make also some short comments on the situation of the Spanish economy. The new government arrived in office only 2 months ago on the verge of Christmas, and 2 days after Christmas, I don't know if it was a Christmas gift or something of a present, we learned that we had an

important slippage in our fiscal accounts. Instead of a deficit of 6 percent of GDP, we had something that was above 8 percent of GDP. The new government immediately in 4 or 5 days took an austerity package to reduce the public deficit by 1.5 percent of GDP, raising taxes, raising the personal income tax. That was something that was not very popular especially taking into consideration that the popular party is a liberal conservative party that is totally against raising taxes, but there was no alternative, and simultaneously -- the public expenditure by €9 billion. I think that this was totally necessary in order to give a very clear signal of the commitment of the new Spanish government with fiscal austerity. The alternative of having a deficit above 8 percent without taking additional measures would have been terrible in terms of the reaction of the markets for the Spanish government. So I think that it was a very clear signal in that regard and it was a very conclusive and rapid reaction of the Spanish government. Immediately afterwards the Spanish government implemented and approved an organic law to develop the constitutional amendment that was approved by the two large political parties of Spain after last summer. And in that law decree, a lot of controls and much more transparency have been introduced with respect to the fiscal accounts. One of the main problems of Spain that I suppose that you are aware of is that Spain is a very decentralized economy. The different

layers of the administration when you look at the different bodies and the different institutions, you notice that regions account for a very important percentage public deficit and the accounts of the regions were quite opaque and they were a main source of deviation and overruns and slippages in the fiscal accounts. So this new regulation will set very clear rules for the regions and especially will introduce a lot of clarity, a lot of transparency to allow the central government to react just in case and in time before the slippages of the regions suppose an insurmountable situation for the global accounts and the global fiscal position of the Spanish economy. So this was a second measure that I think that was quite important and I think that to control and to rein in by the central government and to have transparency and information in time of the accounts of the regions, I think that is going to be another element that leads to the perception that the central government is going to be serious with respect to the fiscal deficit.

Thirdly, the week after the approval of this law, the Spanish government adopted a new regulation on the banking industry. Banks in Spain are important institutions, not only in Spain but all over the world. We have one of the most efficient retail banks and leaders all over the world. But the situation of the Spanish banking industry has been affected by the bursting of the property bubble that we had during last decade and

especially because of the credit bubble that we had in the past.

Immediately the government with the warning of the Bank of Spain, our central bank, also found that we had some deficits in terms of valuation of the real estate assets that the banks had on their balance sheets. We decided to act immediately. What we did was to increase the provisioning of the real estate assets of the banks on the balance sheets of the banks. To give you an idea, the most toxic real estate assets on the balance sheets of the banks is land. Land was provisioned by 30 percent with respect to the initial book value. We decided that this valuation was incorrect and that we tried to close and to bridge the gap between the book value and the market value. So now with the new regulation that we approved, for instance, the provisioning and the markdown of land on the balance sheets of the banks, will be 80 percent instead of 30, to give you an idea about the effort that this is going to suppose for the banks. We will suppose that banks will have to raise provisions by something above 50 billion. They are going to do it through the PNL of the banks. We are going to limit the maximum possible the use of taxpayer money. And for the weak or fragile institutions that are not able to carry out or implement these efforts, what we are going to do is to force them into a consolidation process to try to get rid of these fragile or weak institutions. The idea is not only to increase the provisioning and to make down these assets. The

idea is to have a new round of consolidation in the banking industry in Spain that will give rise at the end of the day to sounder, safer, stronger and with better corporate governance lenders in the banking industry landscape in Spain. We think that clarity and transparency are values and important values and that without transparency and clarity it will be impossible to bring back confidence to the banking industry in Spain. And I think and have the perception that the large lenders in Spain that are very healthy are very happy because once and for all they will be able to get rid of the stigma that they have suffered because of the bursting of the property bubble that I have mentioned before.

Finally, and this was the last piece of regulation that we have modified and I think this is one is relevant to understand the future evolution of the Spanish economy, 2 weeks ago we improved an important overhaul of the labor market regulations in Spain. Labor market regulation in Spain is one of the main causes of the profound and deep deterioration of the labor market in my country. No other country, even the countries with external financial assistance, has suffered the deterioration of the labor market that has offered in Spain.

To give you an idea, you know, at the beginning of the crisis in 2007, our unemployment rate was something close to 8 percent of the labor force. Now it's 23 percent.

In Spain, to give you another figure, you know, more than 10 percent of all the jobs in the broad sector have been destroyed because of the crisis. This does not happen in Greece. This has not happened in Ireland. This has not happened in Portugal.

So there is something intrinsically, I would say, detrimental to the performance of the labor market and the regulation that we had in this thing. So this was, you know, evident for the new government, and, you know, one month and two weeks after arriving in office, well, we have pursued the most profound and deep of our whole of the Spanish labor market through regulation.

The regulation that we had in place, it was a regulation that, you know, had its roots in the Franco Spain regulation. And so we decided that, you know, this is a regulation -- and, you know, it was quite evident for all the analysts -- for the IMF, the OECD, for the economists in Spain -- that this regulation was behind, you know, this truly negative performance of the labor market in Spain.

So, you know, the new regulation modifies dramatically, you know, the situation that we had in the past. We have modified totally the bargaining process in Spain, which the bargaining process in Spain was very centralized -- was based on national and central settlements. And now we have given prevalence to, you know, the bargaining process at

the corporate level, and I think that this is going to be quite important in order to diminish, you know, the impact of any slowdown in activity, you know, at the corporate level.

It's curious, but I have seen in Spain, you know, the situation of a corporation with many companies that have, you know, a drop in activity, a drop in the amount of 30, 40 percent. And simultaneously, they have to follow a settlement, a central bargaining process that forces them to increase, for instance, salaries by CPI plus two.

So the only way out, the only exit that they have, and the final outcome is that they have to fire the temporary workers. This is something that we have to modify, and I think that is going to be, you know, extremely important, and is an important, you know, modification of, you know, the regulation that we have in place.

Secondly, there is another problem in Spain that, you know, is this special duality that we have between insiders and outsiders. And, well, in that regard, severance payments have been reduced, according to the new regulation, to give much more flexibility at the corporate level.

Also, a new contract, a new part time contract with much more flexibility than before, has been approved. And we think that, you know, all in all, you know, in any aspect, in any facet of the poliedric regulation of the labor market in Spain, what I can assure you is that new

regulation, you know, supposes a clearing proof with respect to the past.

Well, this is all the, you know, the main steps that, you know, the new government has taken in two months. We know that we are living in challenging times. We know that this year is going to be, but we are going to have negative growth -- 1.5, more or less, according to the rank of Spain, in terms of GDP -- -1.5 in terms of GDP growth.

We know that the impact on the labor market will continue to be negative, and that we are going to lose jobs this year.

But what I can assure is that the Spanish government is fully convinced that, well, we have to modify a lot of things -- that the start of the year economic policy's going to be based on fiscal consolidation. This is something that is going to be inevitable, but fiscal consolidation is not the only way out.

We have to complement fiscal consolidation with the structural reforms -- the structural reforms that, you know, are going to be needed to foster the growth potential of the Spanish economy in the near future.

Times, in the short term, are not going to be easy. The environment that we are living in is not easy, as you are fully aware. But, you know, when you review backwards the history of Spain, whenever we had, you know, a government with, you know, macroeconomic orthodoxy

implemented, and with a structural reform agenda, always the Spanish economy, at the end of the day, is much stronger.

Thank you very much.

MR. DERVIS: Thank you very much for the comprehensive and yet quick and focused remarks.

I think we're going to mic this.

MR. DERVIS: All right. Now this is better.

So we have about half an hour for discussion with the minister, questions from the floor. I will try, probably, to group two or three questions, to gain time that way.

And so I'm opening the floor. Please do identify yourself. You'll get the mic.

SPEAKER: Thank you, Minister. Thank you, Minister, for those remarks.

The Spanish economy has seen a big deterioration in unit labor costs against Germany. It's running a current account deficit despite recession.

So my question is, is there a big competitiveness gap for Spain today? And what will replace -- how will those happen -- what will replace, for example, the construction sector, et cetera? Which sectors do you see are going to pull you out of this?

MR. DERVIS: He will take one or two others. Yes?

SPEAKER: Thank you, Minister. My name is Juan
(inaudible). I am a student from George Washington University.

And my question is, you said we need a growth policy with a budget policy, and some of the reforms, for example, \$50 billion provision rationing to the banks. So the question is, where are the growth policies?

MR. DERVIS: Any other question the first round?

All right.

MINISTER DE GUINDOS: Well, I think that the questions are quite similar on going in the same direction.

Well, first of all, I have to say that it's true in that, you know, the Spanish economy has a competitiveness problem if you look at the current account deficit.

But it's also true in that the current account deficit has come down from 10 percent in 2008 to something that is going to be a little bit below three percent this year.

So we have closed the gap, and especially if you look at, you know, the performance of the Spanish exports, it's really positive. You know, Spain is the only country in the eurozone that, you know, has maintained its market share in trade, in world trade. You know, we have maintained our market share close to two percent of the total exports of

goods and services.

So it's true that while we have the competitiveness problem, but this problem has been, you know, dramatically reduced over the last, I would say, three or four years.

But the point I would like to highlight is that while the improvement in unique labor costs in Spain has taken place because of a drop in productivity, (inaudible) increasing productivity. But this increase in productivity is the consequence of a dramatic fall of employment.

So we didn't have much moderation in Spain. You can see that, for instance, last year, you know, wages in Spain increased at the rate of two point something percent. Simultaneously, we destroyed jobs at the rate of three percent. So the improvement in unit labor costs that is the typical gauge of competitiveness in Spain has taken place through job destruction.

It's something that we have to modify, and this links to the overhauling of the wage bargaining process. In Spain, we need wage moderation as an instrument, as a lever for internal evaluation, and we have to stop the process of the destruction of jobs. So I would say that, you know, the wage bargaining process is going to be fine now.

After what's -- well, both of you, you have asked about, you know, this dilemma between austerity and growth policies. And I would

like to stress also, you know, one point that I think is important, and Spain is a very good example about growth policies.

You know, in 2007, the fiscal deficit -- well, the fiscal position of Spain was surplus of two percent. In 2009, we had a deficit that was something above 11 percent. So Spain is the country that put in place and pursued the largest fiscal stimulus -- I would say all over the world -- for sure, all over the OECD.

What was the consequence of that? The consequence of that was that, well, the unemployment rate jumped from eight percent to 20. So sometimes -- and I think that despite -- this is quite incorrect -- we are identified for growth policies with fiscal stimuli, and I think that that's wrong. And I think that Spain is a good example in that regard.

So I think that the real pro-growth policies have to come from the supply side of the economy.

The real problem for Spain now is that, you know, we have a good crunch 10:53 that the regulation so far was quite detrimental to job creation, that, you know, the regions of Spain, because of the budgetary problems, have liquidated the strengths, and they couldn't pay to the suppliers. And so, you know, we had, you know, a liquidity situation of a lot of small and medium companies that was really extremely difficult.

So these are the things that we have to modify. We need,

you know, to put in place fiscal consolidation. We need to give the signal that, you know, we are going to put Spain back on track of the fiscal consolidation path, and that, you know, the fiscal position of Spain is going to be sustainable in the future. But, you know, we have to complement that with structural reforms.

If we do that, I think that there is one element that can be modified, that is an intangible in economics, but I think that is quite important -- that's confidence. The problem of Spain is that, you know, confidence, not only outside of Spain but also inside out of Spain, you know, is very, very, very low.

So if we start to raise confidence on our potential and our capabilities, that are huge, I think that, well, this intangible element that is confidence will give raise to, you know, some improvements in economic performance, and I hope that we'll be able to return to the growth situation that we had in the past.

SPEAKER: Anything about growth sectors? Which sectors in the economy?

MINISTER DE GUINDOS: I don't know. I don't know. If I had been told 20 years ago that, you know, a textile company, as in the Anglatex, would become the most successfully clothing textile company all over the world, I would have been quite surprised. I don't know in your

case.

So I don't know. You know, I will have to here be humble, but I can tell you that now Spain have apprenticeship, and that, well, it's curious, but in Spain, you know, we have three of the best business schools in all the rankings in Europe and in the world.

So we have, you know, a potential -- and Spanish interpreters and Spanish, you know, wealth managers are well-educated. You know, they can compete all over the world, et cetera, et cetera.

And simultaneously, well, I think that we have a skilled labor force in certain areas. It's totally true that, you know, the bubble in the real estate gave rise to a quite -- you know, a labor force that was, you know, quite -- they came up with a very, very low level of human capital.

But when you look at other sectors of Spain, one, they are able to compete, as I have said before, and they are able to push, you know, the Spanish economies to compete, you know, in many markets.

So, you know, I think that, you know, the main mission of the government is to try to deliver the structural reforms that, you know, this skillful labor force and, you know, the entrepreneurial force of the Spanish economy need in order to grow again.

MR. DERVIS: All right. We'll have some more questions. I see -- Teresa there first, and then the gentleman there in the back.

SPEAKER: Minister, it is very good to hear that you are optimistic --

MR. DERVIS: Yeah, you have to use the mic.

SPEAKER: -- about the prospect for competitiveness for -- and --

MR. DERVIS: Teresa, we still can't hear you. You have to speak a little louder, okay?

SPEAKER: I said, it's very good to hear that you are optimistic about the prospects for recovery of growth of Spain in the not so far future. I mean, personally, I think that in the short run, we are going to have a hard time, because, you know, a reduction in wages, much as it's needed over the medium term, will have a short term impact on demand.

But I wanted to ask you mainly about the role of the fiscal consolidation in the interim. How are you going to ensure -- what is the government doing to ensure that the decentralization does not, as it has in the past, led to lack of fiscal discipline at the sub-national level?

So thank you very much.

MR. DERVIS: One question yet, in the back there. Yes? Right -- the gentleman in the middle.

MR. VERON: Nicolas Veron at Peterson Institute for International Economics, here and at Bruegel in Brussels.

My question is about the banking system. One striking feature of the consolidation is the banking system, compared to what has happened in Europe in the past two decades -- is that it has been entirely intra-Spanish. There haven't been any foreign buyers that I'm aware of. Maybe it's just ignorance from me, but it hasn't been prominent.

My question is just simply, why is that? I mean, you mentioned a lack of trust and uncertainty, but at the same time, it seems such a golden opportunity for those banks, which are stronger in Europe, to expand their retail base.

So I'd like to hear from you why there hasn't been more cross-border acquisitions in the Spanish banking system. Thank you.

MINISTER DE GUINDOS: Well, your question about the regions and the fiscal consolidation effort of the regions -- well, first of all -- and I would like to put that very clear -- we are not talking about recentralization of the functions of the regions. We are talking about this, you know -- it's an effort of fiscal consolidation of the budgets of the regions.

Spain, perhaps, is the most decentralized economy of the industrial world, of the OECD countries. And, well, we are very happy with, you know, this system of decentralization. I think that it has given rise to a lot of positive elements for the Spanish economy and for the

Spanish population.

But it's totally true simultaneously that, you know, over the last two or three years, the effort of fiscal consolidation of the regions has been much smaller, much more reduced than in the case of the central economy. And this cannot continue that way, especially because now, the regions in Spain, they are confronting a lot of difficulties in terms of liquidity. They have extreme difficulties in top markets to have access to the wholesale finance. And so the only way out is to start to reign in the public deficit.

You know, the main source of the slippage in the public accounts that we had last year in Spain is due to the overrun of the public deficit of the Spanish regions.

So what is going to do, the government? The government, first of all, you know, has agreed -- has reached an agreement with the regions to reach a balanced budget on structural terms in 2020. This goal is to be joined with the rule that has been set in the fiscal compact of the union.

Secondly, I think that, you know, the regions, because of the liquidity problems that they are suffering right now, they are totally open, and they are fully convinced about the necessity of balancing their budgets. And I think that they are willing to make a wholehearted effort in that regard.

Finally, and this is very important because while in the past was the case, we are going to introduce out of clarity, a lot of transparency, in the reporting of the accounts of the regions of the central governments. The regions are an important part of the general government in Spain, they account as I have said before for more than one-third of the total party expenditure. So the government of Spain has to be responsible before Brussels, before our partners in the European Union, about the total consolidated accounts of all the public sector in Spain. So we are going to have and we have set clear signals and clear limits and clear instruments to have information that will be the evolution of the deficits of the regions, to take the correct measures, the proper measures, just in case without any sort of delay.

And finally let me finalize with the political argument that I think is important. While the central government is in the hands of a government supported by the popular party, but also I think that in the 13 regions of Spain that we have the popular party is running, is ruling them, the regions. So there is, I would say, an alignment of interest in that regard to create a framework of fiscal discipline not only in the central government, but also in the different layers of the administration in Spain. So all I know and what I can tell you is that we are fully aware that the control of the public deficit of the region is a vital element, is one of the

main sources of jittery of the markets, vis-à-vis the evolution of the public finances in Spain. And that's why this government and many governments of the regions in the hands of the popular party are going to make a wholehearted effort to send a clear message of fiscal discipline to the markets.

Your question about the banking industry: Well, it's totally true that the penetration of foreign banks in Spain has been quite limited. While in that regard, I have to say that the Spanish banks are regarded as very good in terms of retail banking; that retail banking is one of the advantages of the Spanish economy because the Spanish banks have been I would say quite aggressive and quite competitive in retail banking. So for them it was quite difficult despite the fact that the (Spanish) in the banking industry in Spain have disappeared.

Well, we have the presence of some banks. There are some, for instance Barclays, DMP, but it's not only true that in retail banking the presence of foreign players has been quite limited in Spain. Well, now there is an opportunity. Spain is suffering an important restructuring. The overhauling is going to take place especially in the area of the sitting banks, the famous (Spanish), and this (Spanish) accounted for more than 50 percent of the banking industry. They have started the restructure to be modified.

So there is an opportunity. We are going to have in Spain, as I have said before, fewer players in the banking landscape, but much sounder and much safer and with a better corporate governance because of the flaws that affected the corporate governance of the sitting banks. This is going to disappear. This is something that we are going to modify in the future.

And I think if we give this clear landscape with better rules, with sounder players, with better provisioning, with much more clarity, I suppose and I hope that some international players will be interested in having a presence in Spain. Despite the fact for the banks, this is not the best of the world as you are fully aware.

MR. DERVIŞ: Yes, there's one question there in the middle. Please identify yourself.

SPEAKER: My name is (inaudible). I'm a student at Georgetown University. Thank you very much for coming. So you identified part of the problem as fiscal and discipline for a long time, but Spain's main problem has always been private debt. We're probably around 400 percent of GDP on private debt. And what we're getting from Brussels is more of a Greek problem solution, while Spain's problem is -- although our public finances have not been flawless, they are not like

Greece's. So I'm just wondering, what is the solution to private debt which leads to credit crunches? Thank you very much.

MR. DERVIŞ: Any other question? Yes?

SPEAKER: Thanks very much, Minister. James Daniel from the IMF. I wonder if you could speak a little about the potential risks that you see in your strategy. Where do you see the risk coming from? Is it coming from the economy? Is it coming from social pressure? Would it come from politics? The regions? Is it the unions or the employers? Where do you see the challenges for you in this very difficult job, Minister?

And if I may also ask, on the external side, where do you see the challenges there? And more generally, what can the rest of the world do for you to help you achieve these goals? What can Europe do for you? What can other countries do for you? What would you like to see others do to make your job easier?

MR. DERVIŞ: Maybe as some insight, I can take the prerogative of the floor to ask one question also myself, and that is a little bit following up on the last question in terms of the rest of the world. The current account has become smaller and needs to become even smaller, other current accounts that are in deficit, policies trying to make them smaller. The U.S. current account, I think, for many years many observers have said has to become smaller while that has some implications for

others, for the surplus countries, and both inside Europe and worldwide. So maybe some remarks in terms of the world economy on that front would also be welcome.

MR. DE GUINDOS: Well, except for the last one, the rebalancing of the world economy and the countries with large current account deficits will start to reduce and what happens with the surplus countries. Well first of all what I have to say is that the rebalancing in itself is a matter of confidence. I think that the imbalance in the world economy must be in the crisis that we are living with right now that gave rise to the situation that is totally sustainable. And the perception that I have today is that this rebalancing is flawless taking place. Well, with respect to the surplus countries-- we look for instance at Germany -- well, I think that in the case of Germany you could not expect very expansionary policies in Germany. You have to take into consideration that the German population is aging, that they have to save, and perhaps the perception that they have is that the effort of fiscal consolidation in other countries will be a little bit reduced in order to adjust the fiscal consolidation process to the new situation of a mild recession in Europe. So I would not expect in the case of Europe, for instance, in the case of Germany, of the northern countries, an expansionary policy in fiscal terms. But what I would expect is that they will look for a different pattern of austerity implementation in

the fiscal policy of the southern countries. So I know that it's a subtlety, but talking about this important subtlety in terms of policy implementation. But I think for instance in the case of Germany, they have started to feel the pinch of the recession in Europe. They had no growth in the fourth quarter. So the expert engine of the German economy is not going to be what it used to be only one year and a half ago because the recession is in the rest of Europe. For Germany, for instance, what happens in Italy and Spain is too important. They are very large and important markets for Germany's purpose. So I think that we are fully aligned in that regard.

Well, going to your question about the risks and the challenges: Well, I think that the risk has one positive element is that the political endorsement of the new government is very high while the clear majority in the Spanish parliament, and as I have said before, the popular party runs a majority of the regions. So I think that in terms of political grounds, the popular party has a lot of power, a lot of capability, also a lot of responsibility because like I always say that the responsibility goes hand in hand with your capability and the power that you have politically.

So on political grounds, I think that this is going to be a very important element, and it's a very clear mandate that the Spanish population has given to the popular party to implement the reforms. And I think that the measures that we have taken over the first two months are a

clear sign of that commitment and the compromise of the popular party with these reforms and this agenda of reforms, that I think that has been endorsed by the Spanish population.

The problem -- well, there are potential challenges everywhere. I do not see -- the solution in Spain was so bad that the denigration of the labor markets was so profound that I think the Spanish population is -- despite the fact that some of the measures that we have taken are not popular -- I think that the Spanish population has been relieved because they have started to feel that there is a government that makes decisions, and they wanted to be led. And you can agree or disagree with the measures, but what you cannot question is that in two months the Spanish government has taken bold actions that were not taken before. And I think this is an element of relief in terms of the Spanish population because they want to be run by a government that is fully committed with these kinds of reforms because the alternative is something that we knew and that we have lived over the last four years.

So on political grounds, I would say these are austere measures and to raise the personal income tax for the popular party I can assure you was not an easy decision, but it's something that we have to do. And I think the Spanish population has realized and fully acknowledges that the government can be more or less in agreement with

these measures, but that the government at least is taking measures. And I would say that there is a sigh of relief for that. That's the perception that I have despite the fact that you can agree or disagree. This is a different issue.

From overseas: Well, I think that the European context is going to be vital for us. I think that the second bailout program of Greece is important in order, for instance, to extend the contagion to Portugal that was there because if you look at evolution of yield spreads over the last weeks, in the case of Spain and in the case of Italy and in the case of Ireland, we have seen a tightening of the spreads. But in the case of Portugal, we have seen a widening. I think that this is totally unfair in that there is a clear difference between the Portuguese government and the Greek government. In the case of Portugal, there is a government that is willing to deliver and to put in place the reforms. And I think that at the end of the day, markets will acknowledge this effort by the Portuguese authorities. And afterwards, we have proved fiscal comfort in that we will have to discuss the firewalls or the backstops; you can call it whatever you want. I think that the ECB is doing its part with liquidity that has created much more comfort for the European banks that had to fund the difficult sector and were fully aware only four or five months ago. And I think that the context in that regard has been modified and sometimes the political

limits. Now in Spain and Italy you have new governments that are regarded with much more serious executives, and I think something that are steps in the correct direction. And despite the fact the European Union is much better acting preemptively than fixing the problems and the crisis, I think that we are taking steps in the correct direction.

And finally with respect to the leverage of the (Spanish), the current problem of Spain is not public debt. The public debt ratio is quite low, below 70. But if you look at the broad sector households, both households and corporations, the leverage is quite high. But I recommend you to not listen to fairy tales. The leverage of the households in Spain of the families is below -- is more or less the average of Europe and the problem is the level of debt, the level of leverage, of the corporations. But if you go into the details, you will see that the leverage is especially acute in the case of the real estate companies. So the rest of the corporations in Spain are not as extremely leveraged. The problem has been concentrated on developers and construction companies. The problem of Spain is that -- I think when we left the government in 2004, lending to developers was something above 70 million euros. In 2008, before the bursting of the bubble in Spain, the lending to developers, to real estate companies, to construction companies, was 420. So to give you an idea about the evolution of the credit and that the real problem of the credit

bubble in Spain and the property bubble in Spain was the property bubble. The Spanish banks increased dramatically their exposure to the construction and to the real estate sector. These are the sectors that have to adjust. And I think that through the process of adjusting of prices of the assets, of the real estate assets, that has been and soon to be fostered through the accelerated provisioning that the new government has demanded to the banks. Plus the restructuring of the construction sector, I think that the leverage process will be accelerated, and this is something that is going to be made. But the bulk of the problem of the excessive leverage of Spain, the level of debt of the Spanish private sector, is fully concentrated on real estate and construction companies.

MR. DERVIŞ: Thank you very much, Minister de Guindos. I know you have a very packed schedule and you're heading out tomorrow morning or tonight.

MR. DE GUINDOS: No, no, just now in one hour.

MR. DERVIŞ: I thank you for having visited us. As you see, we've had a full house. I think we've had good questions, good discussions, an overview of the fiscal side, the private sector side, the current account, and the global issues. We wish you luck.

MR. DE GUINDOS: Yes because I always need it.

MR. DERVIŞ: And I think every country, you know there are similarities, but every country is a little bit different in the particular way that the crisis has erupted and the way it is handling it. But I do believe Spain is a country with tremendous potential, and I'm pretty confident now -- it's always difficult for an economist to make predictions -- but if you come and visit us next year, things will have improved.

MR. DE GUINDOS: I will be very pleased to come back here.

MR. DERVIŞ: Thank you.

* * * * *

CERTIFICATE OF NOTARY PUBLIC

I, Carleton J. Anderson, III do hereby certify that the forgoing electronic file when originally transmitted was reduced to text at my direction; that said transcript is a true record of the proceedings therein referenced; that I am neither counsel for, related to, nor employed by any of the parties to the action in which these proceedings were taken; and, furthermore, that I am neither a relative or employee of any attorney or counsel employed by the parties hereto, nor financially or otherwise interested in the outcome of this action.

Carleton J. Anderson, III

(Signature and Seal on File)

Notary Public in and for the Commonwealth of Virginia

Commission No. 351998

Expires: November 30, 2012