

# Letter from the Editors

The global economy enters the autumn of 2025 amid intensifying turbulence. Renewed tariff escalation in the United States, Russia's capacity to sustain its war effort, and China's continued technological ascent are reshaping trade, security, and financial flows. For Europe, these shocks coincide with persistent structural weaknesses, from low productivity and lagging innovation to limited fiscal coordination, while Spain faces the added challenge of adapting to a shifting geopolitical order and incomplete transformation under Next Generation EU. At the same time, pressures in the financial sector, divergent performance on corporate deleveraging, and strains in the long-term care system highlight the urgent need for both resilience in the short term and reform over the longer horizon.

We begin the September issue of *Spanish and International Economic & Financial Outlook (SEFO)* with an assessment of U.S. tariff policy and its uneven impact across global partners. Since 2025, U.S. tariff policy under President Trump has generated significant uncertainty, marked by frequent announcements of steep "reciprocal" tariffs followed by partial reversals or diluted deals. Nonetheless, customs revenue data reveal that the average effective tariff rate applied to most trading partners has remained moderate, far below the levels suggested by headline announcements. China stands out as the exception, facing average tariffs close to 40%, with more than four-fifths of its exports

subject to duties, notably above the share affected under the Smoot-Hawley Act. By contrast, the EU continues to enjoy relatively favorable access to the U.S. market, with tariff rates substantially below those applied to major Asian competitors. While the aggregate impact on U.S. imports has so far been modest, sharp divergences across countries are reshaping market shares, with China losing ground and the EU maintaining stable exports.

The geopolitical risks extend well beyond trade. Russia's resilience and China's rise underscore the systemic challenge confronting Europe. Europe is facing the most profound systemic challenge since the end of the Cold War, as misconceptions about Russia's economic weakness and the resilience of autocracies have obscured the scale of the threat. Measured in purchasing power parity, Russia's economy is the largest in Europe, and its military spending—at nearly 7% of GDP and over a third of its federal budget—places it on par with Europe collectively. This concentration of resources, combined with hybrid warfare and sabotage operations, has enabled Russia to sustain its war in Ukraine despite sanctions. At the same time, China's state-led growth model and technological advances add to the challenge, highlighting the ability of autocracies to mobilize resources for strategic aims. For Europe, incremental responses will not suffice. A bold strategy is needed, encompassing increased defence spending, investment in modern military

technologies, and deeper cooperation through joint procurement and shared assets. The ultimate test for European democracies is to demonstrate their capacity to prioritize security and growth while maintaining cohesion in the face of an assertive axis of autocracies.

These threats expose Europe's structural weaknesses and underline the urgency of reform. Europe's economic malaise is driven by structural weaknesses rather than short-term shocks. Germany's reliance on traditional industries and Spain's reliance on immigration-fuelled growth, albeit providing temporary relief, both highlight the EU's failure to generate productivity. Overregulation, fragmented finance, and chronic underinvestment have left Europe lagging behind in high-tech sectors, while persistent trade surpluses have exposed the bloc to external shocks from Russia, China, and U.S. tariffs. Germany represents 24.5% of EU GDP, but its core industries are stagnating. Europe's tech deficit is stark: of the 50 largest global firms, only four are European. Trade dependency is 22.4% of EU GDP, nearly double the U.S. share of 12.7%, leaving the bloc highly vulnerable to Trump's tariffs—15% across EU exports, 50% on steel and aluminium—which triggered EU commitments of €600 bn in U.S. investment (2025–2028), \$750 bn in energy imports, and \$40 bn for AI chips. At the same time, Chinese exports to the EU rose 8.3% year-on-year in April 2025, while European firms struggle to sell to China. Without reform, fiscal and monetary tools alone cannot compensate. Only a fiscal and capital markets union can provide the scale of investment needed. Otherwise, Europe—including Spain—risks sliding into managed decline.

Spain is directly exposed to this shifting environment, as geopolitical realignments affect its external position and growth outlook. Globalization has undergone significant changes in recent years, particularly since the start of President Donald Trump's second term. World trade and international investment are increasingly following a bloc-based logic, underscoring the weakening of multilateralism. In

this context, the Spanish economy has managed to maintain a significant external surplus, although this result masks two contrasting realities. On the one hand, the trade balance with the EU has improved, thanks to gains in competitiveness *vis-à-vis* EU partners, thereby offsetting the sluggishness of the single market. Between 2019 and the first quarter of 2025, Spanish exports of goods and services to the EU increased by 49%, a rate higher than that recorded by Germany, France, and Italy. On the other hand, the balance with the U.S. and China has deteriorated sharply, particularly since the start of the trade war, as a result of structural weaknesses of the Spanish export model. Spain imports around €45 billion from China, six times more than the €7.5 billion it exports, highlighting the scale of this imbalance. All of this requires revitalizing the single market, strengthening the EU's negotiating capacity, and creating favorable conditions for investment in Spain.

We then turn to Europe's fiscal architecture and the performance of Next Generation EU. Spain has received more than €55 billion in transfers from Next Generation EU, making it one of the EU countries most advanced in terms of formal disbursements approved by Brussels. Yet actual execution lags far behind: in 2024, only €7.5 billion of the €34.1 billion budgeted was disbursed, with less than a third of credits converted into effective payments. Around a quarter of resources have gone to current expenditure, diluting the program's long-term transformative impact. While Spain has complied with milestones to unlock European disbursements, the funds have too often failed to deliver meaningful structural change. With less than two years left before the 2026 deadline, the challenge is not only to accelerate absorption but also to ensure that investments and reforms deliver a lasting legacy.

The financial section of this issue examines the resilience of banks, corporate balance sheets, and digital finance. The 2025 stress tests conducted in the U.S. and Europe produced paradoxically positive results: banks proved more resilient

than in previous rounds despite tougher adverse scenarios. U.S. banks absorbed projected losses of \$550 billion, but aggregate CET1 ratios only fell from 13.4% to 11.6%, a smaller drop than in recent years. Similarly, European banks faced €547 billion in hypothetical losses, yet capital depletion was just 3.7 percentage points, the smallest since 2014. The main factor behind this resilience is improved profitability, particularly higher net interest margins, which have strengthened banks' ability to generate capital organically. These results emphasize the sector's progress in building buffers since the financial crisis, but they also raise questions about whether the tests fully capture emerging risks. Supervisors are already preparing adjustments, including scenarios that integrate geopolitical shocks more explicitly. This paradox points to both the improved health of the banking sector and the continued need for vigilance in an era of heightened uncertainty.

Spanish corporations have reduced their leverage substantially over the past decade, leaving the aggregate debt-to-GDP and debt-to-profitability ratios below the EU and eurozone averages. Indeed, between 2015 and 2024, the ratio of Spanish corporations' debt to GDP decreased by 25.8pp to 63.6%, which is 9.5pp below the eurozone average. This adjustment is also reflected in the decline in the debt-to-net assets ratio, which fell to 34.9% in 2023, its lowest level in almost a decade. Yet, such progress masks significant variation across firms and regions. Larger enterprises remain far more indebted than smaller firms, and leverage is highest in capital-intensive sectors, such as utilities and communications, compared with lower levels in activities like mining or agriculture. Construction and real estate also stand out for the sharp deleveraging they have undergone since the financial crisis. By region, Asturias shows the highest leverage (42.5%), more than twice Galicia's low of 16.2%. These divergences reflect variations in economic structure, firm size distribution, and profitability. Overall, Spain's corporate sector is on firmer financial ground, but leverage remains concentrated in certain types of firms and regions.

Dominated essentially by two players which control approximately 90% of total market capitalization, dollar-backed stablecoins have grown into a US\$219 billion market, increasing their share of crypto trading and cross-border flows while gaining new momentum from recent U.S. regulatory initiatives. In Europe, however, their potential to become a mainstream instrument is limited. Users face exchange rate exposure and issuer-specific risks that are absent from the existing euro-based systems, and the EU's Markets in Crypto-Assets Regulation (MiCA) has already discouraged major issuers from entering the market. At the same time, European efforts to upgrade payment services and advance a digital euro aim to strengthen autonomy and reduce reliance on non-EU providers. Although stablecoins could play a role in cross-border payments, and private and public sector actors should remain vigilant, their systemic relevance in the EU appears unlikely in the near future.

We close with a look at Spain's long-term social and demographic challenge. Spain's long-term care system, one of the cornerstones of its welfare state, is under mounting strain from demographic and institutional pressures. Official projections point to the population over 65 increasing by 1.4 million by 2030, raising demand for care benefits by 27%, with more than 2 million people officially recognised as dependent. Home-based care is projected to represent one-third of benefits by 2030, but this requires a doubling of the workforce to 572,200 full-time equivalents. Yet, the sector continues to struggle with low wages (about €10,000 below the national average), high turnover, and unstable temporary contracts which affect one in four workers. Women make up the vast majority of the workforce, and more than half of employees are over 45, compounding the difficulties of recruitment and retention. Without improvements in working conditions and greater investment, Spain risks a shortfall in the care-related workforce needed to ensure dignity and equity for its ageing population. Ultimately, transforming the system will demand stronger political commitment and significant new funding to keep pace with social needs.