

Letter from the Editors

After several years marked by overlapping shocks—pandemic disruption, geopolitical fragmentation, inflationary pressures and abrupt monetary tightening—the global economy has entered a phase of relative macroeconomic stabilisation. Growth has proven more resilient than anticipated, financial markets have absorbed successive episodes of volatility, and inflation has retreated from its recent peaks. Yet beneath this apparent normalization lies a more persistent challenge: the difficulty of translating favourable cyclical conditions into sustained gains in productivity and long-term growth. Across advanced economies, and particularly in Europe, investment remains the weak link.

Within this context, the January issue of *Spanish and International Economic & Financial Outlook (SEFO)* focuses on that disconnect. We explore why private investment has often failed to respond more forcefully despite strong growth and improved financing conditions.

Our starting point is the paradox at the heart of Spain's current expansion. Healthy economic growth coupled with strong inflows of European funds under Next Generation EU should have created a favourable climate for corporate investment, a key variable for productivity and future prosperity. However, private investment has lagged expectations

while remaining below pre-pandemic levels. Indeed, despite a recent pick-up, gross fixed capital formation among the non-financial corporations lies 1.4% lower than in 2019, adjusting for inflation. This lag reflects the climate of uncertainty, at home and abroad, which has encouraged firms to delay investment decisions and accumulate surplus savings despite positive macroeconomic conditions. To unlock potential private investment flows, it is thus vital to tackle the impediments that undermine the knock-on effects of the Next Generation programme, including the need to increase legal certainty, strengthen institutional stability and diversify the financing instruments available to the economy.

A deeper understanding of this weakness in Spain requires looking beyond headline profits and conventional accounting measures. Spanish non-financial corporations generated modest economic profits averaging 3% of output over 2000–2024, though profits fell near zero during the 2009–2013 crisis and remained weak after the pandemic. Corporate investment mirrored these economic profits, rising when returns exceeded capital costs and stalling when profits were insufficient, even as output and employment recovered. Over the period examined, firms shifted from buying intermediate goods toward internal production, increasing the share of value added and producing more capital-intensive goods. This structural shift amplified the

lag between growth in output and employment and the pace of investment, as firms prioritized profitability over rapid expansion of capacity. Accounting profits masked these dynamics, offering a misleading signal of incentives to invest. The patterns suggest that slow investment in recent years reflects rational adjustments to economic returns rather than widespread financial constraints, highlighting the importance of measuring opportunity costs alongside traditional profit metrics.

Importantly, aggregate indicators often fail to capture the divergence across Spanish corporations. Spanish business profitability follows a clearly procyclical pattern, with the average return on investment reaching 6.7% in 2024, matching levels last observed in 2008 after more than a decade marked by crisis-related volatility. Beneath this aggregate recovery, however, profitability remains highly uneven across sectors, regions, and firm sizes, reflecting persistent differences in productivity, capital intensity, exposure to competition, and business strategies. Microenterprises—accounting for nearly 90% of firms with employees—continue to post the weakest returns, consistent with their pronounced productivity gap, while medium-sized firms currently outperform both small and large enterprises. Sectoral disparities are likewise substantial and persistent over time, with information and communication, electricity, and distributive trade at the upper end of the profitability distribution, and real estate and primary activities at the lower end. Regional differences are largely shaped by productive specialization and business demographics, illustrating how structural features of local economies condition firms' ability to generate profits. Given the central role of profitability in ensuring business viability, supporting investment, and sustaining employment and public revenues, the evidence underscores the need for public policies that foster productivity growth—through stable and efficient regulation, incentives for reinvestment, and investment in human capital, technology, and intangible assets.

Looking beyond Spain, expectations about future productivity are increasingly shaped by technological change and financial markets. Artificial intelligence is emerging as a structural force with heterogeneous effects on productivity, employment, and stock market valuation. Estimates suggest a potential global GDP increase of around 14% by 2030, yet productivity gains remain limited by slow diffusion, uneven adoption, and organizational frictions, with most firms still failing to extract measurable returns from AI investment. At the same time, AI tends to reinforce industrial concentration and labour market polarization, as exposure to automation varies sharply across occupations and countries. Financial markets have moved far faster than the real economy: As of 2025, seven companies account for 35% of S&P 500 capitalization, and equity valuations have reached levels close to historic extremes. This divergence reflects strong expectations of future AI-driven profitability, amplified by abundant global liquidity and speculative dynamics. Whether current valuations can be sustained will depend on the timing and magnitude of realized productivity gains, as well as on how AI reshapes competition, capital allocation, and income distribution.

At the same time, the productivity effects of AI depend critically on how work and skills adjust. Generative AI is already reshaping work, primarily by reorganizing tasks within occupations rather than eliminating jobs outright. Because jobs bundle tasks of varying difficulty, automation can either raise or lower expertise thresholds depending on which tasks are removed, producing outcomes in which wages and employment may move in opposite directions. Task-level evidence shows that roughly two-thirds of tasks removed since the late 1970s were routine, while abstract tasks account for most tasks added, pointing to increasingly divergent labour-market trajectories across AI-exposed occupations. Labour-market impacts will depend not only on technical capability but also on human agency and adoption choices. Firm-level evidence indicates seniority-biased technical change: junior employment declines

following generative AI adoption—driven mainly by slower hiring—with reductions approaching 10% within two years. At the same time, AI offers opportunities in education by scaling expert feedback at low marginal cost, with randomized trials showing learning gains of around four percentage points. Economics education, in particular, is highly exposed to these changes but also well positioned to adapt, provided curricula shift toward AI literacy and complementary skills such as judgement, verification, communication, and applied project work. In Spain, where youth unemployment stood at 25.42% in Q3 2025, these dynamics make the early-career bottleneck especially salient, strengthening the case for expanding AI-enabled training capacity and redesigning school-to-work pathways, building on the demonstrated successes of dual vocational education.

How firms finance investment is an essential part of this story. The European IPO market continues its multi-year slowdown, with Spain mirroring the regional decline despite strong equity returns, record private equity dry powder, and favourable liquidity conditions in 2025. Globally, around 1,300 IPOs raised USD 170 billion in 2025, the vast majority in the United States, while Europe recorded just 105 deals, alongside net delistings in Spain. This disconnect reflects structural impediments: narrow liquidity windows, heavy regulatory and reporting obligations, and fragmented capital markets that amplify execution risk for mid-caps. At the corporate level, European firms often avoid the scrutiny and governance constraints of public markets, instead raising capital privately. Spain's new BME Easy Access mechanism seeks to reduce timing and execution frictions by decoupling admission to trading from fund-raising, potentially easing free-float buildup under volatile conditions. Yet going public remains a strategic transformation rather than a financing event, requiring changes in governance, internal controls, culture, and long-term capital markets strategy. Building a more dynamic European IPO ecosystem will require EU capital markets integration, proportionate listing regimes,

broader investor participation, and a shift in corporate perceptions toward public markets.

Meanwhile, banks remain central to the transmission of financial conditions. The near six-year period from 2020 to mid-2025 offers a complete interest-rate cycle for analysing the evolution of Spanish banks' net interest margins. After prolonged margin compression under zero or negative rates, the rapid monetary tightening of 2022–2023 enabled a recovery driven primarily by funding cost dynamics, followed by a more gradual adjustment as policy rates returned toward a “new normal” of 2%. Disaggregating the margin highlights an asymmetric adjustment between assets and liabilities: funding costs showed lower sensitivity during the tightening phase, while asset yields were more sensitive, driving margin expansion; as rates moved lower, this pattern partially reversed, reducing the extraordinary boost from the liability side and restoring a more balanced contribution to margin generation. However, aggregate results mask structural differences between significant institutions (SIs) and less significant institutions (LSIs). During the tightening phase, LSIs exhibited higher starting margins and lower funding-cost, widening their advantage, whereas SIs sustained comparatively higher asset yields due to portfolio composition. Overall, the cycle confirms that margin resilience depends not only on rate levels but on institutional structure, balance sheet mix, and competitive dynamics in both credit and deposit markets.

Beyond banks, non-bank finance has become increasingly relevant. The non-bank financial institution (NBFI) system, commonly referred to as shadow banking, has reached systemic scale and is now a central feature of global financial intermediation. In Europe, non-bank financial institutions manage more than €50 trillion in assets, around 42% of the financial system, while global private credit has surpassed \$3 trillion, expanding rapidly outside the traditional regulatory perimeter. This growth is accompanied by structural vulnerabilities linked to high leverage, liquidity

and maturity mismatches, and increasingly dense interconnections with banks. Exposures between banks and non-bank entities already amount to trillions of dollars, concentrating risks in a small number of systemic institutions and increasing the potential for two-way contagion. Spain shows a lower domestic weight of non-bank finance, at roughly 34% of the system, but remains exposed through international funds, leveraged credit markets, and indirect banking channels. Shadow banking has become a durable source of both diversification and fragility, strengthening the case for integrated monitoring, cross-sector stress testing, and coordinated regulatory responses.

Finally, the broader macro-financial environment frames all investment decisions. European sovereign debt markets are entering a period of structural change, with declining demand from the ECB and pension systems intersecting with rising supply linked to the green and digital transition, increased defence spending, and support for Ukraine. While these shifts imply hundreds of billions of euros in reduced demand and increased issuance, sovereign spreads have tightened and market functioning has remained notably stable by historical standards. This reflects clearer policy frameworks, greater transparency around ECB portfolio normalization, and more credible government signalling, which have allowed market participants to incorporate evolving demand–supply dynamics into pricing models. This relative stability is reassuring when compared to recent performance during moments of crisis. Market participants should continue to pay attention to the structural changes underway in European sovereign debt markets, but there is currently no cause for alarm.