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Raymond Torres and María Jesús Fernández

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Letter from the Editors

Since the publication of the latest edition of *Spanish Economic and Financial Outlook (SEFO)* last May, two landmark events have taken place. Domestically, Spain´s follow-up, general elections on June 26th should bring increased political stability to the Spanish economy and financial sector. Internationally, the result of the United Kingdom´s referendum to leave the EU has significantly increased the climate of global uncertainty. In addition to Brexit, the global economic context has deteriorated as a result of renewed turbulence in European banking systems, driven by concerns over the soundness of Italian banks, together with general doubts regarding the ability of the EU to stimulate growth and create jobs. Moreover, there has been a weakening of economic growth in emerging economies, notably China and Latin America.

The global economy should, however, avoid a new recession, thanks in part to the support of the ECB´s expansionary monetary policy. In this context, Spain´s economic recovery is outperforming expectations and economic growth should remain relatively strong until the end of the year. Nevertheless, although the electoral period may be over, the deterioration in global conditions, together with the possible end of low oil prices, means risks to projections are on the downside.

On the subject of growth, this *SEFO* looks at the relationship between economic growth and job creation in Spain. Recent evidence suggests that the Spanish economy can create jobs at a lower rate of economic growth than in the past, as a result of structural reforms undertaken in recent years, in particular the labour market reform of 2012, which seem to have made the Spanish economy more flexible and competitive. However, the lower growth threshold for job creation depends on sustaining wage restraint.

Apart from Spain´s economic outlook, this month´s *SEFO* looks at the recent performance of the country´s financial sector, as regards solvency indicators in a European context, and explores the evolution of access to bank finance for enterprises across the EU. In line with the general trend in Europe over recent months, Spanish banks have rapidly increased their solvency, bringing levels in line with the European average. The Common Equity Tier 1 (CET1) ratio has risen to over 12%, close to the 13% euro area average. This has been boosted by two additional factors: transparency, enabling balance sheet quality to be calibrated with relative certainty; and, cost rationalisation, making it possible for Spanish banks to hold on to their advantage in profitability and efficiency relative to the euro area average. Despite the persistence of negative interest rates and deterioration in the global scenario described above, Spanish banks' solvency is not a cause for concern, either in isolation or from a comparative standpoint with Europe as a whole.

According to the ECB´s latest survey data, published in June 2016, Spanish SMEs´

access to bank credit has progressively improved. Access to finance is no longer a major problem for Spanish SMEs and availability of bank loans and some conditions, such as interest rates and loan/credit size, have also improved (albeit collateral requirements and fees appear to be on the rise). If progress continues to be made towards European Banking Union, the economic recovery consolidates, and the ECB's liquidity support and monetary measures are effective, euro area enterprises' conditions of access to bank credit should continue to improve.

We then assess the issue of leverage within the Spanish economy: first, taking stock of the strong deleveraging effort by households and firms; and, second, looking at the evolution of Spain´s public debt and the implications of an elevated debt stock for economic growth. Spanish households and firms have made a considerable deleveraging effort since the beginning of the crisis. Spanish household leverage has fallen from 135% of their Gross Disposable Income (GDI) in Q208 to 106% at year-end 2015, although still above the Eurozone average. Corporate deleveraging has come down over the past three and a half years by 28% of GDP and currently stands below Eurozone levels. Conversely, public debt closed 2015 at 99.2%, which means the leverage ratio for the resident sectors as a whole remains a source of vulnerability for the Spanish economy. In fact, lessons from Spanish history teach us that there is a correlation between increased public debt and a reduction in growth prospects, and that this correlation has strengthened in more recent years. These lessons are particularly important for policy makers to bear in mind when assessing public debt sustainability and when pursuing fiscal consolidation objectives.

In this issue, we also take a look at a relatively new investment vehicle that is supporting the recovery of the real estate sector – the SOCIMI. Only several years in existence, Spain´s listed real estate investment vehicles, known as SOCIMI, are generating a lot of attention and channelling significant sums of both local and foreign investment into Spain´s real estate market. There are currently 19 SOCIMI listed on Spain´s stock markets. Between them, they boast a market capitalisation of over 7 billion euros and total assets of more than 9 billion euros. Based on 2015 figures, two-thirds of the increase in the real estate sector's market cap since the lows of May 2012 is attributable to SOCIMI. Although it is still too soon to draw conclusions regarding SOCIMI's real merit in reactivating the Spanish real estate market, the momentum in these entities' share prices, their substantial market caps and their recent investments in rental properties suggest that SOCIMI's investors are expecting their properties to revalue – mirroring the trend in the sectors of the economy underpinning the recovery underway.

We then discuss developments in the process of integration of European production chains where we find that, overall, EU integration has led to an intensification of international fragmentation strategies of production and the formation of transnational networks. Germany plays a central role in this process, and there has been increased fragmentation of production towards the southern peripheral economies, such as

Spain and Portugal, and more recently towards the eastern periphery.

Finally, we close with an assessment of the role of the social economy in Spain during the crisis. Specifically, we demonstrate how the resilience of Spain´s social economy, which currently accounts for 10% of the country´s GDP, has played a noteworthy role in mitigating some of the negative impacts of the crisis on society, highlighting its countercyclical characteristics.