Letter from the Editors

The new financial resolution framework approved by the Spanish government at the end of August represents another step forward in solving Spain´s banking crisis. The framework´s explicit mechanisms –which include early intervention tools, burden sharing regimes and deep capitalization schemes– can provide a fast response to some of the most pressing problems of the Spanish financial sector. Although the transition period from implicit resolution mechanisms, which included regulatory forbearance and restructuring, to more explicit resolution actions, like the one approved, may have taken longer than desired, the new framework is most welcome. However, there is no time now for complacency and, as important as the tools themselves, is the efficient and correct execution of the implementation process. In our opinion, some relevant aspects of this framework are yet to be defined and it is advisable for the details to be defined as soon as feasible –particularly if the intention is to attract participation of investors. As an example and with respect to the "bad bank", we expect a more precise definition of key details, such as capital structure, type of assets to be transferred and value of the assets, among others. In this fourth issue of SEFO, we take a closer look at international experiences of "bad banks" and also the Spanish case. Many countries have adopted bad banks to find solutions for different types of banking crises and it is illustrative to compare the initial circumstances and strategies pursued by each country.

The implementation of this new financial resolution framework is taking place in an environment of significant foreseeable regulatory changes and in a context of EU

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banking integration. In this context, many forces are at work, some pushing towards integration and other pushing against. In the section of this SEFO devoted to an examination of the Spanish banking sector and the European single banking market, we would like to highlight our concern about the significant retreat in integration suffered in the past years as a consequence of financial instability, uncertainty and the economic crisis. Part of the loss of confidence in Spain is attributable to problems in the design of the EMU and the lack of a single banking market. In our opinion, urgent actions should be taken to recover the lost ground and accelerate the creation of an integrated banking market. Without a supranational authority with banking regulation and supervisory power, unified deposit protection and banking crisis resolution mechanisms, and harmonization of certain key areas, a single banking market will not be possible. A closer look at Euro area economy financing reveals the increasing role of the Eurosystem and how its funds have replaced a good portion of private capital mainly in peripheral economies. The imbalances generated in the financial accounts of peripheral countries –with increasing private capital outflows and resource to the Eurosystem´s liquidity – and core countries –with increasing capital inflows and excess liquidity– signal a source of concern with respect to increasing financial fragmentation within the EMU. We welcome the ECB´s institutional support announced on September 6th, as well as recent steps taken towards EU financial integration and supervision at the informal ECOFIN Council meeting that took place in mid September in Cyprus. We also point out that the rhythm of adjustment in economies with internal imbalances is increasing. However, we would like to highlight our concern, particularly when there is still so much divergence across member states on how to move forward.

To conclude, since Spain's economic recovery continues blocked by factors that are holding down national demand but also by financial constraints, any removal of these barriers represent an important step forward in helping Spain out of this crisis.