Letter from the Editors

While the international economic context appears to have improved since last summer, recent events, such as the outcome of the Italian elections and the proposed bailout of Cyprus, provide evidence of the still fragile situation in Europe. Spanish growth is expected to recover in the final months of this year and continue to grow moderately throughout 2014. External financial conditions have improved, but domestic credit constraints will likely continue until the restructuring of the financial sector is complete.

The key topic of the March SEFO is the Spanish mortgage framework with an assessment of issues, policy options, and implications. Although the crisis hit Spain later -but more severely than most other developed countries- residential mortgage Non Performing Loan (NPL) ratios have remained relatively low. This is true even after the property bubble had burst and despite the unfavorable macroeconomic context. However, as in many other countries on both sides of the Atlantic, foreclosure rates have been on the rise and the situation is generating an intense social debate.

In response, the Spanish government has initiated Parliamentary debate on new measures directed at the mortgage market. The Government plans to reform the *Ley Hipotecaria* (Mortgage law), including more favorable terms for mortgage holders such as: limitations on late interest payments and making evictions, and the establishment of a moratorium on evictions for the most vulnerable, among others. Finally, the Government has proposed to give judges case by case jurisdiction to halt evictions in instances of abusive mortgage contracts, in this way transposing the court ruling issued recently by the European Court of Justice as regards the Spanish mortgage market. At the same time, the Government has rejected other proposed measures, such as to reform retroactively the dation in payment. Even though the law is still subject to amendment and final approval by Parliament, it appears that in the end, the reform will improve debtors´ protection without significantly damaging or altering the mortgage market.

Furthermore, we explore one of the fundamental roots of the banking crisis in Spain, the housing market, analyzing supply and demand conditions to determine the outlook for the property sector. We conclude that in the context of current macroeconomic and demographic conditions, a robust recovery in the Spanish property sector is unlikely in the near term. Even if lower prices stimulate sales, it will likely still take some time for the stock of housing to be absorbed.

The strategy of Spain´s bad bank (SAREB) to sell off acquired property assets will have to adapt to this situation. Indeed, SAREB´s provisional business plan already contemplates an extended period of up to 15 years to complete the sale and envisages macroeconomic and financial developments in the Spanish economy and, in particular, the real estate market.

Moving onto a different subject, another area that has been particularly affected by the crisis is *bancassurance.* Today, this sector provides one of the main distribution channels of insurance products in Spain. As a result of the crisis and financial sector restructuring, many credit institutions and insurance providers will have to rethink their existing business agreements and strategies over the coming year to resolve conflicts that have arisen under existing commercialization agreements, search for other distribution channels, or because new agents might appear in the insurance market.

Finally, we look at an issue in the Spanish energy market with important financial implications- the electricity tariff deficit, which stood at 30 billion euros at the end of 2012. Due to its size and evolution, the tariff deficit presents a key challenge for regulators searching to mitigate market inefficiencies without creating further distortions. The problem of the power tariff deficit cannot be solved in the short run unless consumer prices increase and/or the costs of the system decrease. However, the underlying reasons for the deficit should not be overlooked. The market’s organization should be designed so as to prevent any future deficits.