Letter from the Editors

There have been some recent positive events at the local, European, and transatlantic level, that may have important implications for Spain. At the national level, the latest economic indicators suggest the economy is stabilizing rapidly. We have also seen a reduction in Spain's risk premium, accompanied by the increase in returns on German debt. Furthermore, the country continues to advance on the private sector deleveraging process related to the property market and household debt. In Europe, September consensus forecasts show that perceptions of economic conditions have improved over the last few months. There has also been progress on legislation for the so-called Banking Union, specifically advancement towards the Single Resolution Mechanism. Finally, this summer marked the commencement of negotiations on the EU-US Transatlantic Trade and Investment Partnership, the largest proposed bilateral trade agreement in history.

In this context, this September issue of the SEFO analyzes the significance of these events and their possible implications. As stated recently by both the IMF and the European Commission, deleveraging remains one of the major challenges for the Spanish economy. Over the past few months, we have witnessed some progress in the housing market adjustment. The recent evolution of house price indices shows that they are finally adjusting fast and remain on a declining path. In addition, large operations in the Spanish real estate market have helped to increase the confidence of international investors. The more optimistic outlook in the housing sector, together with increased financial stability, is helping the process of household deleveraging, which has accelerated in recent months, allowing families to gradually increase savings and net financial wealth. From 2005 to 2008, Spaniards increased debt by 260 billion euros. From 2009 to 2012, this debt has been reduced by 90 billion euros, suggesting that a long deleveraging process still lies ahead and that Spanish families should continue to rebalance their debt to equilibrium levels, more suitable to the reactivation of internal demand and achievement of higher economic growth rates.

In this SEFO, we assess the government's recently approved electricity sector reform. The latest reform represents part of Spain's austerity drive and a much-needed effort to reign in the electricity deficit in the face of weak demand and overcapacity. The reform will contribute to financial stability in the sector, but questions remain as to whether or not it will be sufficient to eliminate the deficit, as well as to resolve regulatory uncertainty and improve investment climate in the sector.

In addition, we take a look at progress on the Banking Union initiative at the EU level. As this SEFO points out, public sector aid to the banking sector in the wake of this latest financial crisis has cost the EU as a whole almost 1.3 trillion euros or 10% of EU-27 GDP. In Spain, the aid granted was in line with the EU average, but the losses realized and hence passed on to the public deficit were greater due to the fact that the bulk of the capital aid transferred was to absorb losses rather than taking the form of financial transactions, such as buying shares. The cost of the EU banking sector bailouts demonstrates the need to make urgent progress on the Banking Union initiative. In light of this, we examine the latest proposals for the Single Resolution Mechanism presented by the Commission on July 10th as a complement to the Single Supervisory Mechanism. Together, the two pillars of the Banking Union are envisioned to operate to prevent the emergence of large-scale financial crises and to tackle them in an orderly manner, reducing the damage for the public sector and for taxpayers, in the event that they occur. Although negotiations on the Banking Union are progressing slowly given political considerations, we expect progress over the coming year.

Aside from progress on financial regulation, last June the EU entered into negotiations with the US for the creation of the Transatlantic Trade and Investment Partnership. The effects of reaching a free trade agreement between today's two main economic areas are significantly positive and are estimated, in the best-case scenario, to generate close to 120 billion euros per year for the European Union. Ex ante assessments of the proposed agreement show that Spain will be one of the countries to obtain the greatest welfare gains from the bilateral partnership – 6.55% of GDP per capita in the more ambitious scenario. Second round negotiations are scheduled for October.