Letter from the Editors

The November SEFO highlights a turning point for the Spanish economy, as the country came out of recession in the third quarter of 2013 with growth of 0.1% – the first quarter of growth after nine consecutive quarters of contraction. The process of adjustment and correction of imbalances has progressed sufficiently to allow for domestic demand to stabilize and the economy to emerge from recession, with the help of the external sector´s positive contribution. However, given the low growth rate, and the remaining need for adjustment, we cannot yet say that the crisis is over nor that we have started a new economic cycle that is capable of job creation.

In the financial sector, the last two reviews by the European Commission, European Central Bank, and International Monetary Fund concluded that Spain´s financial sector assistance program remains on track, with all of the conditions established by the MoU already in place. In general, the financial sector continues to advance in the restructuring and recapitalization process. In addition, there have been some recent positive developments in terms of boosting supervisory powers at the Bank of Spain and the FROB, Spain´s financial sector restructuring fund. Finally, the Bank of Spain has also increased transparency through its forward looking assessment of the Spanish banking system, ahead of the ECB´s planned comprehensive assessment in November 2014. As regards the ECB stress tests, there are several issues yet to be resolved related to treatment of Spanish banks´ assets. The results of the Bank of Spain´s assessment reveal that Spain´s loss absorption capacity and Common Equity Tier 1 capital ratio would be adequate even under an adverse scenario.

On a related note, in this issue, we examine Spain´s new Alternative Fixed Income Market (MARF), launched in October 2013, in line with the MoU commitments to develop alternatives for non-bank funding. Given the experiences of similar markets in other countries, MARF could improve Spanish companies´ access to finance given the current context of financial disintermediation in the wake of the crisis. Nevertheless, it remains to be seen if MARF is compatible with the composition of Spain´s corporate structure. The results of leading new issuers will also play an instrumental role in setting the tone for investor confidence, and thus, to some degree, the ultimate success of the MARF.

Economic activity has stabilized and the financial assistance program remains on track. However, the Government still faces a long road towards fiscal stability. The last few years of weak economic conditions and structural problems of the Spanish economy have made fiscal consolidation harder than initially expected. In this context, the November SEFO takes a closer look at Spain´s public finances. Spain is currently in the midst of a notable fiscal rebalancing process. These efforts have been reflected in the easing of sovereign spreads. Nevertheless, consolidation has been uneven across the different levels of the public administration, with the greatest difficulty for meeting deficit targets in 2014 for the autonomous regions and social security. As our analysis of the 2014 Budget reveals, while improved economic conditions and extension of 2012/2013 tax measures into 2014 should help fiscal accounts, limited discretionary power to cut spending will make fiscal consolidation one of Spain´s key challenges over the coming years.

Finally, we examine the international expansion of Spanish firms. While the crisis has resulted in Spanish firms reducing their net investment abroad (as a result of divestments or geographic refocusing), exporting activity quickly recovered after the crisis, returning to maximum historical levels and resuming its pre-crisis growth track. Despite progress, Spain´s corporate internationalization remains concentrated in a handful of companies and industries. Geographic diversification beyond Europe and Latin America could also be increased, in particular in the case of outward FDI. Only time will tell if internationalization will successfully spread throughout the rest of Spain´s corporate sector.