Letter from the Editors

The elevated private debt level in Spain, and particularly of non-financial corporations (130% of GDP in 2013), is often cited by international institutions as the main obstacle to a sustained economic recovery. Given the significance of this problem, in the May issue of *Spanish Economic and Financial Outlook,* we focus on recent developments in Spain´s debt market and their possible implications for the country´s banking sector.

Beginning by taking a comparative snapshot across bank restructuring and recapitalization processes across Europe over the past years, our analysis shows that Spanish banks have undergone a deeper restructuring relative to their European peers. Now these efforts are paying off, as evidenced in part by restored confidence in the Spanish financial system and, subsequently, improved funding costs, better performance indicators relative to EU peers, and finally, larger economies of scale.

In this context, we examine the latest legislative measures for refinancing and restructuring Spanish corporate debt and their anticipated impact on banks´ balance sheets. The new measures aim to ensure survival of viable companies that cannot meet their debt servicing obligations due to the current economic climate, together with their elevated debt levels. Some of the most relevant measures include: haircuts or debt capitalizations, suspension of enforcement actions, elimination of effective veto powers held by minorities, tax exemptions and improvements to the treatment of provisions made by banks for refinanced and restructured credit. On the whole, the impact of the measures on the banking sector should be positive, as they facilitate the debt restructuring of viable companies and encourage an adequate analysis of operations and of their most sensitive aspects, which could improve banks' capital positions.

This SEFO also tracks the evolution of Spanish financial flows and debt dynamics. The heavy reliance of the private sector on bank debt, together with the combination of private sector

deleveraging and public sector leveraging, has led to a decreased reliance on bank finance, while leading to an increase in the relative share of securities market debt. However, market-based finance is still too low in the Spanish economy, and heavily biased toward the public sector.

Considering this trend, Spanish SMEs will need to be able to access new forms of finance outside traditional banking channels, on which they tend to be over-reliant. The May SEFO explores recent developments in the area of access to SME finance. The latest ECB survey data reveal that while most European companies perceive an improvement in access to credit, many still feel that overall credit conditions, such as interest and non interest rate costs, as well as collateral requirements, have deteriorated. This is particularly the case for SMEs versus large firms, and even more so the case for Spanish SMEs versus their euro area counterparts. Bank of Spain data confirm there has been a recovery of credit for Spanish SMEs, in line with the ECB survey results, however, given the importance of SME´s to the productive fabric of the Spanish economy, broadening their access to finance is key to sustain the economic recovery.

This month´s issue also takes a look at the adjustment in Spain´s labor market, providing evidence of some flexibility in Spanish wages in response to the crisis, and debunking the perception that the adjustment process has been the cause of growing income inequality. In fact, adjusting statistics for composition bias shows the burden of the adjustment has fallen more heavily on higher paid workers and workers in the public sector.

Finally, we assess the Spanish government´s medium-term fiscal consolidation strategy through 2017. Overall, the targets agreed upon with the EU seem feasible and credible. Nonetheless, under current economic projections, the fiscal consolidation process may be insufficient to ensure public debt sustainably. The accumulated debt stock, together with the low inflation rate imply higher real growth rates and/or primary surpluses are needed to stabilize the debt.