

## Letter from the Editors

Since the start of the recovery, the Spanish economy has significantly outperformed expectations, leading both public and private institutions to continuously revise upwards their forecasts for this year and next. In March last year, when FUNCAS first published its growth forecasts for 2015, the estimate was 1.8%, in line with the consensus of Spanish private analysts' forecasts and above that of leading international organisations. In contrast, the most recent consensus growth forecasts now range between a minimum of 2.6% and a maximum of 3.3%.

The economy is being driven by endogenous cyclical factors and structural improvements, together with a series of transitory external shocks, such as the drop in oil prices, the reinstatement of part of public sector employees' extraordinary pay, income tax cuts, a drop in interest rates, and pre-election spending. The agreement reached between Greece and its creditors is also expected to reduce some of the recent tensions in European and Spanish markets. However, the expansionary impact of some of these positive shocks is anticipated to wear off in the near-term, and the growth rate is forecast to slow to 3.0% in 2016. Moreover, taking a long-term perspective, the Spanish economy's potential growth rate, once the current output gap is eliminated, will probably fall short of the rates we expect to see this year and next.

In this context, the July SEFO examines some of the post-crisis conditions within the Spanish economy today. We take a look at access to both bank and non-bank finance for Spanish corporates. As regards bank credit, according to the latest

ECB survey data, referring to the situation between October 2014 and March 2015, access has improved, particularly at the SME level, breaking the negative trend in recent years. Overall, bank credit is more abundant and less expensive. Credit to SMEs for new operations is growing strongly, and the difference between the interest rates Spanish SMEs and their European peers pay for bank loans has dropped by more than half since end-2013. In parallel, the spread that Spanish banks charge for new SME loans has also fallen since mid-2013. Aside from the economic recovery, progress on banking union, ECB liquidity support measures, and Spain's financial sector restructuring have all supported the latest improvements. While access to bank finance for SMEs has improved on the whole, micro-enterprises are benefiting least from the favourable changes.

The July SEFO also explores recent trends in Spanish corporate bond issuance. In Spain, as in the rest of Europe, the crisis brought to light the excessive reliance of the corporate sector on traditional bank finance. This realisation, together with factors, such as the reduction in benchmark rates in response to ECB intervention, the compression of Spain's risk premium, and improved financial health of Spanish non-financial corporate issuers, has allowed for a deepening of Spanish debt capital markets in line with the European trend. These developments largely apply to medium-sized and larger firms, but the greater availability of previously tied-up bank funds should help small businesses meet their needs.

Apart from the increased reliance on debt capital markets, Spanish corporates are

witnessing a notable improvement in the array of funding sources available, including new, innovative forms of alternative finance. Recent regulatory measures designed to make bank finance more flexible and accessible, paying more attention to SMEs, at the same time aim to strengthen other sources of non-bank finance. If we look at the broader definition of alternative finance, which includes non-bank funding and market access for SMEs, we find that there has been a relative improvement, with the Alternative Stock Market (MAB in its Spanish initials) and venture capital showing promise. At the same time, while crowdfunding and Peer-to-peer (P2P) business lending remain at a very incipient stage, accounting for only 62 million euros of total funding in 2014, their growth in the coming years is expected to be formidable.

Moreover, the July SEFO takes stock of Spain's industrial landscape. It is true that the crisis exacerbated the deindustrialisation trend observed in Spain, further widening the gap relative to other OECD countries which began intensifying since 2000. Of the EU's larger countries, Spain has suffered the worst destruction in manufacturing firms, with losses exceeding those in other peripheral countries, arguably due to the severe adjustment in the construction sector. Nevertheless, the scenario coincides with a profound change in the global structure of the industrial sector in favour of newly industrialised countries. The decline is likely to continue in the coming years, given the expected prevalence of the three main factors behind this trend: structural change, foreign trade and "servitisation" and the outsourcing of service activities. In this context, there has been renewed interest in the industrial policy debate, with both the US and EU introducing measures to

support industrialisation goals. In Spain, the focus should be on slowing the country's pace of deindustrialisation relative to the OECD average through defining priorities in manufacturing and devoting more resources to technology, financing and training policies within the sector.

This SEFO also provides some reflections on one of the socioeconomic impacts of the recent crisis in Spain – the increase in inequality. We analyse how the country's ambitious fiscal consolidation plans and structural reforms may have avoided the worst of the crisis, but are likely to have further aggravated inequality. As regards fiscal consolidation, pressures in Spain led to a halt in long-term trends of steady increases in health and education spending, supporting some of the empirical evidence regarding Spain's recent poor performance on various equality indicators. As regards structural reform, preliminary evidence points to the most adverse effects of the latest labour market reform on lower wage earners.

Finally, we close this issue with an assessment of the latest update of Spain's Stability Programme, which contains relevant changes to the government's forecasts for economic and fiscal variables. The updated program reflects a more ambitious expenditure reduction effort and more favourable macroeconomic scenario for the first two years from 2015-2016, with greater uncertainty over both elements in the subsequent two year period. On the whole, the government's fiscal consolidation path is perceived as feasible, although subject to considerable risks on the expenditure side related to effective execution of planned expenditure reduction measures and performance of the social security system and the autonomous regions.