Letter from the Editors

Deleveraging has been one of the most frequently used terms in reports on Spain in recent years. It is generally understood to be a rebalancing that demands short-term sacrifices but supports long-term growth and remains a necessary condition for the consolidation of the Spanish recovery. In this context, the November issue of *Spanish Economic and Financial Outlook* (SEFO) starts off by taking stock of progress on the deleveraging efforts of Spanish households and firms over recent years.

Spain is among the countries having made most progress on deleveraging since 2010, and efforts appear to be compatible with an increase in new lending flows and a gradual recovery of financial savings. Between 2010 and June 2015, Spanish households and firms reduced their debt by 450 billion euros, or 37.5% of GDP. At the same time, while the rate of change of the stock of credit to the private sector remains negative, it has dropped from -5.3% in 2012 to -2.7% in August 2015. Credit to SMEs stood at 146.6 billion euros in 2014, and is estimated at 159.8 billion euros by year-end 2015. Moreover, financial savings has gone from negative values in almost all sectors before the crisis to an increase of up to 2% for the country as a whole in June 2015.

In this issue of SEFO, we also explore recent progress and outstanding challenges for the Spanish financial sector post-restructuring. The adjustment (restructuring, write-offs, public aid) undergone by the Spanish banking sector in response to the crisis has allowed Spanish banks to become well positioned on the ranking of EU banking sectors in terms of profitability and efficiency. Spanish banks´ solvency levels have also improved and capital ratios are above Basel III minimum requirements, although below the EU average. At the same time, today´s low interest rate environment, together with increased capital requirements, continue to place downward pressures on banks´ profitability. To overcome these and other outstanding challenges, banks must further boost efficiency and adopt new business strategies reliant on increasing scale, international diversification, and on-line and mobile banking service provision.

The November SEFO then shifts its focus to the challenges of the Spanish corporate sector, such as the need for increased reliance on non-traditional funding sources, competitiveness challenges in the manufacturing sector, and finally, the internationalisation process of Spanish firms. We start by looking at the rise of non-bank financing alternatives for Spanish SMEs, pointing out important developments at the EU level to increase firms´ reliance on capital markets funding, such as the European Commission´s Action Plan on Building a Capital Markets Union (CMU).

In Spain, alternative financing channels have deepened and now include equity financing options, such as crowdfunding or venture capital for smaller firms, as well as alternative exchanges and private

equity for larger-scale entities. On the debt side, non-bank financing alternatives include debt crowdfunding platforms for smaller firms, together with fixed-income exchanges, such as MARF for medium-sized companies. These alternatives are a necessary step forward and have encountered strong institutional support. However, many obstacles remain, such as changing the mentality of SMEs towards alternative financing and the size constraints of European and Spanish SMEs.

We then study the process of internal devaluation across Spanish manufacturing firms, which reveals broad differences in competiveness of exporting firms relative to domestic-oriented players. As a result of rising unit labour costs during the economic expansion, Spanish manufacturing firms catering to the domestic market lost cost-competitiveness as they increased prices in order to protect profit margins. By contrast, the competitiveness of export-oriented industries, in terms of costs and products, progressed more favourably. Consequently, Spanish exporters' market share has done well relative to global exports. Falling wages during the crisis years could be driving manufacturing's recent take-off, a necessary preconditions for generating a more sustainable growth model in Spain, although it is still too early for definitive conclusions.

Taking our analysis of Spain´s export industry a bit further, we consider the internationalisation of Spanish firms, focusing on the performance of Spanish exporters relative to other large EU economies, to find that Spanish businesses have internationalised substantially in recent years. However, they are still a long way from securing net exports comparable to large European exporters, such as Germany, the Netherlands, or even Italy. Moreover, at the micro level, our findings shows exports to be concentrated, where 15% of large, frequent exporters account for 90% of Spain´s exports by volume, alluding to the existence of growth constraints experienced by many smaller export businesses.

Lastly, this SEFO examines issues related to public-sector employment trends and the characteristics of Spain´s labour market. Following a period of growth from 2007-2011, subsequent cuts in public-sector employment, in part driven by the need for fiscal consolidation, brought figures back in line with 2007 levels. The impact of the cuts, however, was mitigated by the general increase in the number of hours in the working week from 35 to 37.5. Staff reductions were mainly achieved through net job losses affecting temporary contracts, posing challenges for the future as regards the cyclical or structural nature of the policies implemented, and the provision of certain public goods and services.

On the topic of labour markets, according to empirical evidence, workers who enter inflexible labour markets, such as those in Spain, during times of economic recession fare worse than those who enter more flexible ones. Moreover, while Spain has recently completed a much-needed labour market reform, not enough has been done to reduce segmentation, so it is likely that these negative effects will still be applicable to the current generation of individuals that graduated during the recent financial crisis.