While the recession slowed development in Spain, its exports have remained strong, particularly in pharmaceuticals and automobiles, giving Spanish Prime Minister Mariano Rajoy (left) particular cause for optimism.

Spain gains ground

Spain's recent economic struggles may be well known, but those paying attention see signs of recovery starting to emerge. And for those keeping an eye out for new investment opportunities, the country has definite potential.

Spain has been in the spotlight for all the wrong reasons recently. The housing market collapsed, the banking crisis deepened and austerity measures were introduced that many considered crippling. This led to rampant unemployment and frightened off many investors, wary not only of the country's economic travails, but also the perceived weakness of its institutions, both public and private.

According to Spanish Prime Minister Mariano Rajoy, that's all set to change: "The debate isn't 'Is Spain going to have a bailout?' or 'Does the euro have a future or not?'... the debate is 'When is Spain going to recover and how strong will the recovery be?'" he said in a recent interview with Bloomberg.

"Right now, Spain is coming out of the recession," he added, "and next year Spain will have major economic growth."

Spain's Economy Minister Luis de Guindos echoed this sentiment, albeit in slightly more guarded terms: "This is the beginning of the end of this crisis," he said in an interview with Associated Press. "Next year, we are going to see an important reduction in the unemployment rate" – the first since the downturn began in 2008 and vital to the country's future.

This isn't just political posturing. Indeed, Spain is rapidly becoming one of the most attractive investment locations in Europe. This is the view of Ignacio de la Torre, group economist at financial services firm Arcano.

To tackle the pessimistic consensus on Spain, de la Torre highlights various economic indicators illustrating the revival. Unexpected gems include a housing market in which prices have bottomed out, a banking sector close to achieving its stability targets and an export sector that is the strongest in Europe. Spain is now a thriving environment rich in high-yield-to-risk investment opportunities.

To illustrate the market misreading of Spain, de la Torre points to credit default swaps: during the financial crisis, Spanish CDS prices were comparable to Egypt.

"In the first half of 2011, people thought Egypt was less risky than Spain," he says. This changed following the military

coup and near civil war in Egypt, but Spain continues to be perceived with unjustified caution. "Today Spain is still considered more risky than Kazakhstan," he adds.

All about the exports

The market has been slow to acknowledge Spain's economic revival. Using exports as the key indicator of recovery, de la Torre says, "the country has improved its current account by 11 to 12 points of GDP in just five or six years. If this trend continues, then Spain is going to be the Western country with the second highest current account surplus after Germany. This is an export-led recovery."

And why are Spanish exports so strong? While the UK has enjoyed a modest improvement on the back of sterling's slide, Spain has booked strong performances even with nations that share the same currency. "In the first half of the year, Spain increased exports by eight percent compared to a negative performance by the eurozone," says de la Torre. Even Germany failed to grow exports during the same period. Exports to the Middle East and Latin America are also up sharply. And exports cover a large range of sectors, so it is no flash in the pan. The root causes are labor-force reforms and culture, he says.

"Real wages have adjusted dramatically following labor reforms. The average annual salary in Spain is €23,000, compared to €33,000 in Germany and €35,000 in France." This, in turn, helped to offset the fractionally lower productivity of Spanish workers compared to those in France and Germany.

But internal consumption levels were widely seen to be a serious flaw in the recovery story.

"Internal demand went down 19 points," he says, "and everyone believed it was going to be a nightmare." Not so. Consumer confidence levels are at a two-year high.

De la Torre points to a growing list of indicators that support his positive outlook. Air traffic has improved and car sales recovered from minus ten percent in the first quarter of 2013 to plus two percent in the second quarter. Electricity consumption is still shrinking slightly, but at a noticeably slowing rate. Plus inflation, measured by the consumer price index, has fallen from 2.7 percent to 1.5 percent, which bodes well for real wages in the future.

He also suggests investors should look at Spanish public firms that are profitable, but owned by cash-hungry municipalities eager to raise cash. Local governments may have substantial real estate holdings they need to sell under duress.

Spain's economic fundamentals have improved, de la Torre argues. It is no longer the weak link characterized by crippling debt, undercapitalized banks and a legal framework fraught with uncertainty and delay.

Towards better regulation

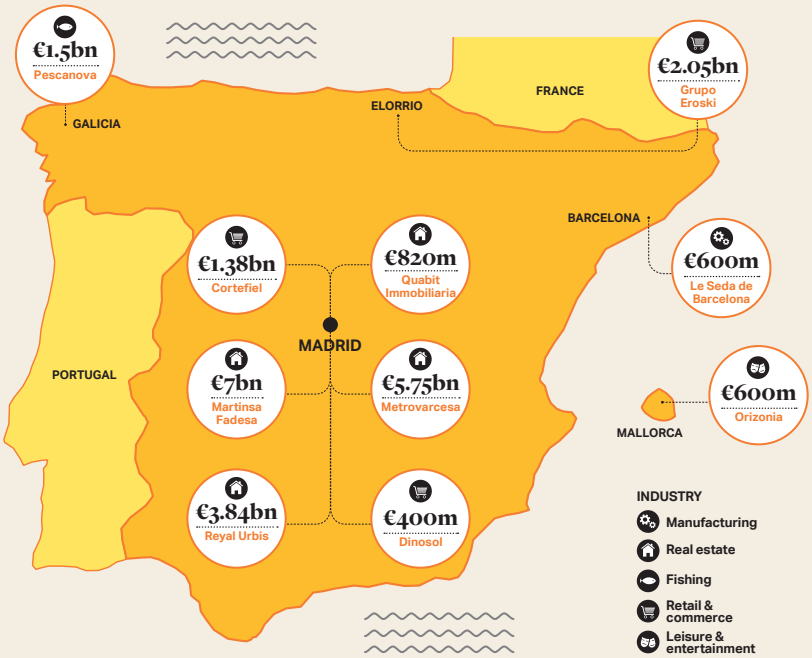
The figures do appear to back up this optimistic stance. While unemployment remains stubbornly high, some markers are improving. Consumer credit is slowly shifting upwards, while factory order books are showing healthy growth (helped in part

Opportunities in Spain

Economic indicators appear to show signs of recovery in Spain, opening the door to a range of new investment opportunities, according to experts.

RESTRUCTURING DEALS IN SPAIN

Source: Debtwire



SPAIN IN NUMBERS

40%

reduction in private lending over GDP since 2007*

-6.5%

monthly average fall in retail sales during 2013**

11.2%

bad loans as a percentage of total lending in 2012*

96%

forecast number of general government debt of GDP by 2014*

Sources: *Banco de Espana **SNIS

by the improved productivity of Spain's workforce, nervous over redundancy and more willing to work longer hours than their counterparts in Germany or the Netherlands).

The markets appear to endorse the optimism, too, with the news that Spanish 10-year bonds' yield premium over German bunds fell five basis points to 277 bps, its tightest since early August 2011.

Fiscally, while Spain remains in critical condition, even the primary deficit is heading in the right direction. That has been bolstered by Spain's encouraging political stability, in contrast to some other EU countries. Institutional reform has certainly helped not only in the government, but also in streamlining Spain's private sector.

Juan Manuel de Remedios, partner at White & Case in Madrid, takes up the point, saying there has been a significant improvement in the country's insolvency regime thanks in part to legislation enacted in 2009 and 2011 designed to ease the passage of restructuring negotiations.

"As Spain's economy and regulatory environment keeps strengthening, it is likely to attract greater investment from overseas," he adds.

He notes that recent efforts to promote out-of-court refinancing agreements have had mixed success because the first creditors to apply for insolvency in Spain benefit from having half their claim treated as a privilege. Unfortunately, the prognosis for proceedings in the Spanish courts is poor, with around 90 percent of insolvency proceedings resulting in liquidation, a discouragingly high ratio.

He also points out that debtors in pre-insolvency situations are entitled to a three-month period of grace for negotiations with creditors to reach a refinancing agreement.

"However, during this grace period, a creditor may still bring the enforcement of security interest action against the debtor or set of claims, which would seriously compromise any proposed out-of-court restructuring," he says. All of which contributes to

ROAD TO RECOVERY

Source: OECD

27%

predicted level of unemployment in Spain by the end of 2013 – it will remain above 25% for the next five years

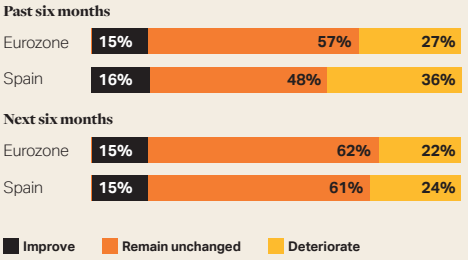
-1.7%

forecasted level of shrinkage in the Spanish economy in 2013 – with a predicted level of 0.4% real GDP growth in 2014

AVAILABILTY OF BANK LOANS*

Source: ECB 2013

*based on a survey of 903 Spanish SMEs



a situation where many Spanish firms seeking to restructure look towards the UK.

"As a process, UK courts give you certainty and predictability, which is everything an investor wants," says Christian Pilkington, Financial Restructuring & Insolvency partner at White & Case. He has acted on numerous schemes of arrangement for foreign companies whose only connection to the UK is the law governing the documents and the exclusive jurisdiction of the UK courts.

Pilkington points to the percentage deleverage figure as the best demonstration of the flexibility of such schemes. "At one end of the spectrum, you have Wind Hellas, where 100 percent of the debt was written off and the senior lenders took over the equity. Compare that to Primacom, where none of the debt was written off. Part of it was structurally subordinated, maturities were extended – but none of the debt was written off. And you have everything in between."

> **"As Spain's economy and regulatory environment keeps strengthening, it is likely to attract greater investment from overseas"**
>
> Juan Manuel de Remedios, Partner, White & Case, Madrid

Until recently, the absence of a cram-down mechanism in Spain has fueled this move to the UK. The Spanish Parliament has now approved an amendment to the Insolvency Act which, among other things, reduces the percentage required for a court homologacion (i.e., "cram-down") from 75 to 55 percent of the liabilities held by financial institutions. A court can impose a stay, which has been accepted by the financial institutions, representing at least 55 percent of all debtors' liabilities with financial institutions. That stay is imposed on all unsecured dissenting or non-participating financial creditors. This amendment should be perceived as a positive thing for Spanish businesses facing difficult times.

Keeping your eyes on the prize

Despite the continuing improvements in Spain's institutions and regulatory regime as well as the signs of an economic revival, there is no doubt that challenges remain. Recovery from such a deep and sustained recession won't happen overnight.

"While Spain's recovery seems to be in progress, it depends in part on recovering economies elsewhere in Europe. Spain's strong export market, for example, relies on the strength of other EU economies," says Pilkington. "We need to keep a close eye on how wider issues in Europe might affect Spain.

"For example, the country's largest export partner, France, is having its own troubles, unveiling a 2014 budget that was described as 'painful for everybody' in the national press, which could have an impact. Spain's next major export market, Germany, has just had its growth forecasts for 2013 cut in half by its leading economic institutes, while at the same time anticipating higher private consumption in 2014, leaving the situation cloudy at best. While there remain reasons to be optimistic about Spain's prospects, it's vital that investors keep a close eye on the bigger picture."

By guarding against complacency and urging everyone to join the effort, the Spanish government is clearly grasping the nettle. It has even launched a campaign to boost domestic tourism under the banner of "Spain: Your Inner Destination" – it seems getting Spaniards to believe in recovery may just be the start. And savvy investors could be along for the ride.