

20 August 2022

Interview with the Deputy Governor published in TELVA magazine*

Margarita Delgado, Deputy Governor, Banco de España

* English translation from the original in Spanish

Of all the problems we're now facing, which do you think will impact household finances the most?

We're dealing with a crisis that follows on the heels of another. For me, the overriding concern is uncertainty. We've just emerged from a totally unexpected phenomenon, COVID-19, which has had an uneven impact across sectors and households. And just as the recovery was taking hold, commodity prices started to rise as a result of the international trade supply bottlenecks triggered by the pandemic. And then, regrettably, at the beginning of the year, came the war in Ukraine, which has led to higher and particularly more persistent inflation such as we've not seen for a long time, but which we'll gradually have to get used to.

We've lived through a dystopian summer, with a war on Europe's doorstep, heatwaves, wildfires ... Russia knows that wars are won in the winter and is now threatening to cut off our gas supply. Is Spain not taking this seriously enough?

Spain is in a better position to start with, as we're not expecting to suffer energy supply shortages. Europe is dependent on Russian gas, some countries more than others, for example, Germany or even Italy. But for better or worse, we live in a global world and although Spain's exposure to the Russian economy is very limited, beyond certain trade issues, the higher energy prices have an impact on all inputs, which is why inflation is also rising in Spain.

The CPI increased by more than 10% to June and wages have barely risen by an average of 2.45%. When the rise in the cost of living far outstrips that of wages, what can we do?

The war in Ukraine has made inflation more persistent. We buy our energy abroad and the country as a whole is more impoverished. We feel that this situation warrants an effective measure such as an incomes agreement between all the social partners, the more broad-based the better, for both the public and the private sector. Wages need to rise somewhat below inflation and firms need to refrain from passing on all their cost increases to

consumers, temporarily squeezing their profit margins. We must also take into account the most vulnerable sectors of society and make sure that the support measures in place are very much geared towards them. Such an agreement should avoid triggering an inflationary spiral with feedback effects on prices and costs. In short, we all need to tighten our belts. Otherwise, we'll enter an inflationary spiral with dire consequences for future economic growth.

What wage increase do you propose? 2.3%?

It's not for the Banco de España to say how much wages should go up or profit margins down. That's for the social partners to decide. But we do advocate moderation. According to our latest projections published in June, average inflation is estimated at around 7.2% in 2022, falling to 2.6% in 2023 and to around 1.8% in 2024. All of this subject to the uncertainties we're currently facing (the interview took place at the end of July).

The unemployment rate has dropped to 12.48%, the lowest since 2008. Does this call for optimism or should we exercise caution?

The unemployment figures for the second quarter were good, both in the industrial and the services sectors, closely linked, in the latter case, to the summer season and the end of the health restrictions. Also, unemployment fell to below pre-pandemic levels in the last quarter of 2021, which is positive. However, we'll have to wait to analyse the impact the cuts in Russian gas supplies may have on some European countries, and how this affects our economy.

On 21 July, in a historic move, the ECB raised its interest rates by half a point, the largest increase since June 2000, in the words of the ECB president, Christine Lagarde "to ensure the return of inflation to 2% in the medium term" (in 2024). What does the Banco de España think of this? Was it taken by surprise?

The Governor of the Banco de España is a highly active member of the ECB Governing Council and decisions are generally taken by consensus. We must bear in mind that interest rates have been in negative territory for the last five or six years, something that isn't normal in a lender-borrower relationship. Nor is it normal for depositors not to receive any returns on their money. If monetary policy starts to normalise and interest rates are positive, and this is achieved gradually and moderately, taking into account the macroeconomic impact and also the need to contain inflation, we see no reason why this rate rise should have a negative impact on the economy. But I insist, this is based on the premise that all these decisions are taken and implemented gradually.

Of course, but people with mortgages or who are planning to buy a home are worried because they fear they've missed their chance and don't know whether to change to a fixed rate or continue with a variable rate...

Obviously, I can't express an opinion on individual investment or borrowing decisions. These must be weighed up by each person, depending on their income, wages and time frame. What I can recommend is that they go to our Bank Customer Portal (cliente.bancario.bde.es/pcb/en), which will help them make informed decisions. There, we provide calculators that simulate interest rates, repayment terms and amounts, so that they can work out what the loan instalments would be. As a matter of fact, compared with a not-

so-distant past, present interest rates are not excessively high. EURIBOR stands at around 1%. According to our research, it will not have a major impact and the economy will gradually adapt.

The US Federal Reserve has already raised its rates to 2.5%. Will we follow suit?

There are major differences in the growth and inflation dynamics of the United States and the euro area. The monetary policy response in these two regions does not necessarily have to be exactly the same. Also, we find ourselves in a setting of extraordinary uncertainty and, in consequence, as the ECB has pointed out, the most advisable course of action is to set the pace of monetary policy normalisation meeting by meeting. What I'm trying to say is that, right now, it's impossible to say where interest rates will be, either in the United States or in the euro area, even in the coming quarters.

Back in 2008, the Banco de España warned of a real estate bubble. Are we in a similar situation now?

We are indeed observing an increase in the number of transactions and in prices, in some areas more than in others. However, looking back, house prices have fallen sharply in recent years, by as much as 30% or 40% in some locations. All in all, we don't see any worrying signs of overheating or of a widespread real estate bubble. Also, compared with 2008, construction now accounts for a much smaller proportion of the economy. Bank lending to the construction sector has been falling steadily since 2012. We're closely monitoring developments in the real estate sector, because we want to avoid a repetition of disastrous past scenarios.

Bank mergers, the disappearance of local savings banks, branch closures, mandatory early retirements by the thousand... Do we have a better, more solvent, banking system now?

The answer is a definite yes. The industry is far better positioned than it was 15 or 20 years ago, banks' solvency levels are much higher and, what's more important, their internal management systems, governance and liquidity have all vastly improved, making them better prepared for future crises.

Do you think that the new temporary banking tax, of 4.8% on net interest income and fees charged by banks, which they cannot pass on to customers, could damage their solvency?

Spain has a sound banking system and its solvency shouldn't be compromised by this tax. Let's see what form it ultimately takes. Although our banks' income statements could benefit from a gradual rise in interest rates, we'll have to be cautious regarding the impact on the Spanish economy of all the uncertainties we're currently facing. The banking business is vital to the economy. As supervisors, we want banks to earn money because if they don't, they won't be able to adequately fulfil their role of channelling funds to the economy, to allow investments to flow where they're most needed.

Banks, in their efforts to cut costs, have claimed some victims, such as the elderly, who need digital skills they lack, and small towns and villages, stripped of their ATMs and branches. Can banks be obliged to meet these needs?

Digitalisation is here to stay. For banks, it's one of the ways in which they can cut costs and make their business profitable. Technology is everywhere, not only in the financial sector, but, having said that, no one should be left behind. A protocol has been signed with the Ministry of Economic Affairs, establishing measures such as extending counter service opening hours or having staff to directly serve elderly customers who are unable to use technology. As regards the abandoned rural areas of Spain, other alternatives are being explored, such as mobile bank branches in the form of buses, the use of the postal service network to provide cash to customers or even installing ATMs in public spaces such as town halls.

The US has technically moved into recession, with two consecutive quarters of negative growth. Are there concerns about a recession in Europe? How does the current euro-dollar parity affect our pockets?

We don't see anything resembling a recession in Spain on the immediate horizon. We're expecting growth of 4% this year and of around 2% in 2023, give or take a decimal point or two. Of course, there's no such thing as zero risk. The uncertainty remains and we can't rule out the possibility that some quarters may not be altogether positive, or that the potential interruption of Russian gas supplies to Europe, essentially to Germany, could have a negative impact on economic growth. As for the euro-dollar parity, two issues are at play here. First, energy, since although Spain has a strong renewables sector, it also needs to import energy which it pays for in dollars. So even when wholesale energy or oil prices moderate or fall, a strong dollar does not benefit us. Second, we have a sizeable export sector, which has seen us through past crises. Spanish firms have greatly expanded internationally, and with a cheap euro, they're now more competitive. And let's not forget the tourism sector, which is also benefiting from this situation.

Negotiations on the 2023 State Budget have started, with higher spending on defence and pensions. How will this affect us individually?

We can't judge what the Government, as a sovereign power, does regarding each specific expenditure item. That is not our place. Our assessment is far more global. We advocate a medium-term fiscal consolidation plan, to give us some degree of certainty as to what will happen with the public debt/GDP ratio (which stands at 115%). These levels exceed what is to be expected from the fourth largest economy in the European Union. I would like for us to return to a more moderate path on both the expenditure and the revenue side.

People worry that they won't receive their full pensions. What are the Banco de España's forecasts?

The future of our pensions concerns us all. We need to assess the measures and reforms introduced by the Government and approved by Parliament, but so far there are insufficient data available.

Are the British model or the Austrian "backpack" model, on which you've just published a study (which involves each worker having an individual fund to which their employer makes monthly contributions and which they can take with them when they change jobs) being considered?

The current Spanish system has been very successful in guaranteeing income levels for all pensioners. But the issue here is whether the sustainability of pensions can be guaranteed in the future. It's not so much a matter of changing models as of exploring other interesting alternatives, one of which is the Austrian "backpack" scheme. With so much insecure and temporary employment, a large section of the population can't make ends meet, even though they're working.

According to the INE, 27.8% of the Spanish population is at risk of poverty. What prospects do your indicators point to?

This percentage reflects the situation at the height of the pandemic. Although it's difficult to predict what will happen in 2022, with so much uncertainty that could have an impact on euro area growth, our indicators point to some degree of recovery in employment which, in principle, is a positive sign.

These poverty figures contrast starkly with the apparent holiday madness, with record occupancy rates and soaring prices. Have we stopped saving?

I'd have to answer this question from a more sociological, even psychological, viewpoint. No, we haven't thrown caution to the wind. Spain continues to have a sound savings rate, we've saved during the pandemic and this is no doubt a positive factor that will generate further growth. The thing is, people very much want to enjoy a good holiday, without restrictions, and this goes beyond purely economic considerations.