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Address to the Club Siglo XXI

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Introduction

Let me begin by thanking the Chairman of the Club Siglo XXI, and my good friend, Chenchu Arias, and the management of the Club for their kind invitation to me to join you today. Over the years this Club has seen debate on all – or practically all – matters, and naturally on economics too, which will be our subject today.

My address will focus on the European and Spanish economic situation.

Situation of the European economy

With a decade now having elapsed since the international financial crisis began, we can say that the euro area is finally in a phase of sound and vigorous economic expansion.

GDP growth is expected to have posted a growth rate of around 2.5% in 2017, a figure not seen since the early years of the monetary union. The favourable economic situation extends, moreover, to all corners of the area, including the economy that has undergone the greatest difficulties, namely Greece. It is expected that in the coming months Greece may successfully conclude its third financial assistance programme.

Further evidence of the soundness of the recovery is the dynamism of business investment following years in which the expansion of household demand, acting as the sole engine of growth, appeared to be decoupled from the need for firms to increase their capital.

Reflecting the strength of the expansion has been a notable reduction in unemployment rates, which are generally standing at pre-crisis levels. However, substantial cross-country differences persist in this area, with unemployment levels ranging from below 4% in Germany to 20% in Greece.

The favourable financing conditions associated with the extraordinary monetary policy measures implemented by the Eurosystem have no doubt been one of the essential determinants behind the economic recovery transforming into a vigorous expansion. To illustrate this, the estimates made by the Banco de España suggest that the monetary policy measures contribute to accounting for practically half the euro area economy's observed nominal growth since mid-2014.

Adding to this is the greater buoyancy of world trade, which recouped growth rates not observed in the five previous years. This result reflects the favourable cyclical juncture at which many advanced and emerging economies now stand, but also a true recovery in the sensitivity of trade to global growth, despite the protectionist threats that have emerged and that may put a brake on this fundamental engine for economies as open as the European ones are. The strength of exports has contributed notably to sustaining the greater buoyancy of the aforementioned investment.

Another factor contributing to the expansion has been the headway in the ongoing deleveraging that households and firms have had to undertake. Currently, in the area as a whole, household and corporate debt is drawing closer to observed pre-crisis levels, with a greater correction in the more vulnerable countries being discernible. Fiscal policy, too, retains at present a more neutral stance, following the public finances consolidation process pursued.

Against this background, household and business confidence has reached levels at an all-time high since the creation of the monetary union, suggesting that growth will be maintained in the coming quarters. Most analysts have revised their GDP growth forecasts upwards, placing them for this year at around 2.3%.

The economic expansion has not yet or hardly been reflected in prices. Core inflation – which excludes the most volatile components – has remained anchored at around 1% for several years now. Behind this lies the moderation that wage growth continues to show across the board, despite the fact that in some economies unemployment levels are low in historical terms.

Highly diverse factors contribute to explaining the phenomenon of wage moderation. Of note, in my view, is the role played by the low productivity growth in the European economies and the greater importance that may have been accorded to indexing to past inflation when negotiating wages in the context of persistently very low inflation rates in recent years. The significance of part-time employment in the current recovery and the inflow of immigrants are also factors that may have checked wage growth in some economies.

The fact that wage restraint is not a development exclusive to the euro area suggests that factors of a more global nature may also be playing some part. Among these the greater interrelatedness of economies, which has been conducive to global value chains being extended, may have led to the international determinants of price- and wage-setting increasing in significance, at the expense of the traditional determinants. Other explanations highlight the influence that the automation of productive processes, the digitalisation of economic relations and the development of electronic trade may be exerting.

Beyond the macroeconomic area, the expansion opens a window of opportunity to continue entrenching the foundations of the monetary union project, completing the banking union and taking the first steps towards a fiscal union that enables adjustment costs to be reduced when the economy faces an adverse situation. Further, the negotiations in the coming months on trading and financial arrangements with the United Kingdom also pose another major challenge to the functioning of the single market.

Situation of the Spanish economy

Let me now move on to the Spanish economy.

The strength of the recovery is proving notable. On the latest estimates, our GDP is estimated to have grown by around 3.1% in 2017, that is to say, similar growth to that in 2015 and 2016; for the third year running, the growth of our economy is expected to have clearly exceeded that observed for the euro area as a whole. Indeed, last year we regained the level, in real terms, of our pre-crisis GDP.

There are two key features of this recovery. Firstly, it is proving to be most job creation-intensive. However, we are still far from attaining the employment levels prior to 2008. The second notable feature is that our recovery, which has been intense and prolonged, is proving compatible with the correction of the imbalances that emerged in the years running up to the crisis; in particular, it is proving compatible with the maintenance of a substantially positive external balance.

In 2017 we posted a current account balance of around 2% of GDP, a figure not far removed from that observed in the four preceding years. Admittedly, transitory or temporary factors – such as low oil prices and low interest rates, for instance – have exerted an influence on this surplus; but largely it is due to gains in external competitiveness and also to the reduction in the economy's financing costs, a development in which the Eurosystem's monetary policy has played a crucial role, as have the structural reforms made since 2011.

Outlook

On the latest Banco de España projections, which we published last December, the current upturn may be prolonged over the coming years with significant growth in activity and employment, albeit at lower rates than those observed in the last three years.

This moderation in the increase in activity would be firstly attributable to the lesser momentum of demand-side policies. Specifically, we expect the impulse derived from fiscal and monetary policy to be lower, as well as lower growth of private consumption compared with that in recent years.

As regards gross capital formation, investment in housing will be spurred by the generation of employment and the availability of low-cost financing. This latter factor will also be conducive to business investment, further to the far-reaching clean-up of corporate balance sheets in recent years.

With respect to external demand, exports may be expected to continue outgrowing the rate of expansion of the very markets on which they are targeted, which reflects the gains in competitiveness I referred to earlier. But I believe mention should also be made of a structural change, namely the most notable growth in the number of Spanish companies permanently – not just occasionally – orienting their activity towards foreign markets, without forgetting the gains in market share in their domestic markets, as gains in competitiveness enable firms to compete better not only abroad but also, obviously, in the domestic market against imports.

Risks

The Spanish economy has moved into 2018 on the back, we may say, of significant expansionary inertia.

On the external front, and in Europe as a whole, we do not yet know and it is not easy to estimate the impact that the United Kingdom's exit from the European Union may have, the impulses that the protectionist policies in various countries are prompting and the effects that may stem from the re-balancing of the Chinese economy. In the financial domain, the valuations of certain assets in some jurisdictions and segments of the capital markets have increased most markedly, suggesting that there has been an increase in the risk of there being corrections in the coming years potentially affecting financial stability.

I would also like to refer to the economic risks posed by the political situation in Catalonia.

In our *Financial Stability Report*, published early last November, the Banco de España estimated a range for the economic impact of the tensions in Catalonia drawing basically on assumptions about their duration and intensity. The conjunctural information for the final

quarter of 2017 indicates that economic activity is expected to have slowed in Catalonia in the closing months of the year to a greater extent than in the other main regions with the greater GDP; at the same time, it seems clear that the application of Article 155 of the Constitution has contributed to easing economic tensions, as shown by recent developments on financial markets, where a correction has been observed in the higher volatility and more negative dynamics that stock markets and the Spanish sovereign debt risk premium had experienced in the opening weeks of October. Indeed, the risk premium stood today below 85 basis points relative to the German benchmark, the lowest level since 2010, following the upgrade announced by a rating agency.

If in the coming months we achieve normalisation, understanding by normalisation a situation in which political agents act with a real observance of our entire legal framework to the letter, and I would stress *real observance*, that would very likely lead to a better growth scenario than that considered in our latest projections and to an ultimately moderate impact.

If, on the contrary, such normalisation does not come about, that may affect consumption and investment more markedly. A further loss of confidence may prompt households to increase their precautionary saving and to postpone their consumer-durables and house purchase decisions. And, above all, it may affect business investment in Catalonia, given that the climate of uncertainty would delay the undertaking of new investment projects and set back hiring decisions. Moreover, these effects on investment and consumption decisions might extend to both resident and non-resident agents, adversely affecting variables such as tourism and foreign investment. The outcome would be a greater adverse impact on activity both in Catalonia and in the Spanish economy as a whole.

Conclusions

Allow me to conclude.

In addition to the risks I have highlighted, we are facing other problems, chief among which, owing to its far-reaching and numerous consequences in the medium and long term, is the ageing of our population, which is expected to continue and even intensify in the near future.

This process involves various adverse effects, including most notably, as we all know, the challenge that a progressively longevous population poses to the public pensions system. The reforms in recent years have been appropriate and have contributed to shoring up the system's financial sustainability; but adverse demographic developments require measures whose application should not be delayed.

Population ageing gives rise to a reduction in the proportion of the total population making up the workforce, which negatively affects productivity and our economy's ability to innovate and incorporate new technologies. Given that it is impossible or very difficult to change demographic trends, even in the medium term, it will be important to persevere in enhancing the education system and pursuing the institutional and regulatory reforms that contribute to improving productivity, promoting or enabling greater competition and innovation.

Thank you very much for your attention.