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**Developments in the economic situation**

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## **Introduction**

Let me begin by thanking the Tenerife Asociación Española de Directivos for their kind invitation to me to join you today.

## **The European environment**

I shall devote my address to the current situation of the Spanish economy. I will begin by highlighting the favourable cyclical juncture at which the euro area – the economic environment closest to us – stands. The upturn in which the euro area economy is immersed may be classified as robust and dynamic, and extensive to all productive sectors and countries.

The euro area economy began to show signs of strength in the closing months of 2016, and these stepped up in the second half of last year. As a result, GDP at the close of 2017 was growing at 2.7%, a rate not seen since the start of monetary union and one significantly above what was expected a year earlier. These figures comfortably exceed the potential GDP growth estimates for the area as a whole and thus contribute to erasing the negative output gap generated by the crisis.

One of the characteristics of the current expansionary phase is its intensity in terms of job creation, meaning that the euro area as a whole has now exceeded pre-crisis occupation levels. Wage restraint and the reforms carried out in some countries have been conducive to the vigorous response by employment to economic growth. The euro area-wide unemployment rate has fallen to 8.7%, compared with levels close to 13% at the height of the crisis, although there are substantial cross-country differences, ranging from an unemployment rate below 4% in Germany to 20% in Greece and 16.5% in Spain.

Moreover, a balanced pattern of economic growth can be seen. Adding more recently to the momentum of private consumption, the sole engine of growth of the start of the recovery, has been the dynamism of business investment. Low financing costs, the sound performance of final demand and high capacity utilisation are enabling investment to pick up to pre-crisis levels. However, factors persist that might restrict medium-term investment projects, including most notably low potential growth expectations, the adjustment of balance sheets and the correction of high corporate debt levels still under way, and the problems that are creating political uncertainty.

Euro area exports, boosted by more buoyant global trade, are also contributing to the momentum of activity. And this despite the notable appreciation of the euro since last spring.

Undoubtedly, a significant factor underpinning the recovery has been the maintenance of an expansionary monetary policy, which has allowed financing conditions to be relaxed, contributing to the upholding of both private consumption and the recovery in investment. Specifically, estimates by the Banco de España suggest that the series of monetary policy measures adopted since mid-2014 might account for close to half of the nominal GDP growth in the euro area from 2015 to 2017.

Nonetheless, the buoyancy of activity has not yet been accompanied by a sustained increase in the inflation rate. Once the more volatile components such as energy and fresh food prices are stripped out, core inflation remains, as it has done for several years now, at low levels of around 1%. Many factors are behind this behaviour of prices, some of which are external in nature, such as globalisation, changes in oil and commodities prices, and technological progress, which have exerted very durable effects on prices.

But to date, moreover, there has been very contained wage growth in the euro area as a whole, which is in contrast to the clear improvement in employment. Low productivity, the weight of past inflation on wage-setting processes and the presence – still – of some slack in the area's labour markets, as reflected by high long-term unemployment and the presence of a notable volume of involuntary part-time employment, hamper, in my opinion, higher growth in wage income.

### **The recovery of the Spanish economy**

I shall now move on to the essential features of the Spanish economy's recovery and to the outlook for the continuation of the upturn.

The current recovery is proving most intense. GDP grew in 2017 by 3.1%, the third consecutive year of growth above 3%. The strength of growth, which has throughout the expansionary phase outpaced that observed in the euro area as a whole, enabled Spanish GDP to resume its pre-crisis level by mid-2017.

One significant characteristic of the current expansionary period is the fact that the sustained growth of activity has given rise to a high rate of increase in employment. Here, however, much remains to be done, since the current level of occupation is still some distance off the pre-2008 level.

Another notable feature of the current recovery is the progress made in restoring macroeconomic and financial equilibria. This is playing a key role when it comes to explaining the intensity and duration of the current upturn. In this respect, it is worth mentioning the continuing and notable positive external balance and the subsequent reduction in the economy's – and in particular the private sector's – over-indebtedness; such progress has proven vital for restoring the confidence of foreign investors and of Spanish households and firms.

The current account balance stood at close to 2% of GDP in 2017, a similar figure to that observed the previous year and up on the figures recorded in the early years of the recovery. True, some factors that have contributed to this improvement in the economy's external balance have effects that tail off over time. This is the case of oil prices which, despite their recent rise, remain lower than those in force until mid-2014. Also, the improvement in financing conditions in recent years has provided for significantly lower interest payments abroad.

Other explanatory factors behind the improvement in the balance vis-à-vis the rest of the world are structural in nature. I refer here to the economy's enhanced competitiveness, the

most striking manifestation of which is, perhaps, the notable correction observed since the start of the crisis in unit labour costs compared with the euro area as a whole.

It is thus notable that, unlike previous expansions, the current phase is characterised by the fact that the increase in Spanish household and business spending is proving compatible with the deleveraging of the economy, meaning that we are not – if you will allow me the expression – “buying” growth at the expense of credit from the rest of the world. This confers upon the current expansion a more sustainable nature over time and one less vulnerable to potential sources of risk.

## **The outlook**

What may we then expect in the coming years?

Here I shall refer to the latest projections by the Banco de España, published last December. The baseline scenario expects the expansionary phase to continue over the next three years, in a setting in which progress in correcting imbalances will continue to support both domestic spending and exports. At the same time, the growth rate of GDP is expected to be somewhat less high than that observed in the past three years.

In terms of components, the increase in output in the coming years will continue to be underpinned both by the buoyancy of private national demand and by the positive contribution of net external demand. As regards national demand, a moderate slowdown in private consumption may be expected, against the backdrop of smaller increases in employment, following several years of strong growth as a result of pent-up demand during the crisis.

Investment in housing will continue to grow notably, boosted by job creation and the availability of credit under favourable conditions. Also, business investment will remain robust, in line with the expected course of final demand, against a background of most notable headway in the ongoing restructuring of corporate balance sheets and of persisting easy financial conditions.

Turning to external demand, the cumulative gains in competitiveness that I referred to and the sound outlook for the international economy as a whole and, in particular, for the euro area, are expected to continue making for a dynamic Spanish export performance.

## **Risks**

This predominantly favourable scenario is subject to various sources of risk.

For example, developments on global financial markets. In February we saw how the high valuations attained by certain financial assets can give rise to bouts of price corrections and notable rises in volatility. Any future intensification of these episodes, which to date have originated in US markets, might have adverse consequences for economic activity and for financial stability.

Furthermore, it is complicated to anticipate how Brexit, and its consequences in terms of trade in goods and services or in movements of people and capital, will unfold. But, in any event, protracted uncertainty over the final agreement intensifies the risks of an adverse impact on activity.

On the domestic front, the risks associated with the political situation in Catalonia remain. The baseline scenario of our December projections included the negative effects of the increase in uncertainty relating to political tensions. Specifically, on that occasion it was considered that the scope of the events already observed would be relatively limited and temporary, albeit not negligible.

So far, the information available appears to confirm that recent economic developments are not far removed from the scenario anticipated, with effects that appear to have been confined to Catalonia. Specifically, since summer 2017, the performance of the Catalanian economy appears to have been relatively worse than that of the rest of Spain in terms of the figures, for example, on domestic spending and tourism.

Elsewhere, the indicators measuring the degree of economic and financial uncertainty suggest a reduction in this variable.

The incidence of this source of risk will depend on the intensity and persistence of the tensions. An easing in these tensions might lead to higher growth than that considered in our December projections. Conversely, a hypothetical rebound in tensions might lead to an increase in uncertainty resulting in a more pronounced impact on agents' spending decisions.

## **Conclusions**

I shall now conclude, setting out once more our main challenges.

As I said, the resilience of the Spanish economy to future adverse shocks has increased following the crisis. But we cannot be complacent. If we wish to shore up this resilience, we must proceed further with the design and application of reforms that tackle the main long-term challenges: productivity, a reduction in structural unemployment and tackling the consequences of population ageing. These are reforms whose positive effects can only fully crystallise following a lengthy period of time. This is precisely why it is desirable that we should set about them as soon as possible.

Among the challenges outstanding, I would highlight that of population ageing, owing to its far-reaching consequences, the effects of which will make themselves felt in numerous areas. These include most notably, and primarily, the compatibility between the sustainability and sufficiency of the public pensions system, against the background of the progressive rise both in life expectancy and in the number of pensioners relative to current employees, but also other potentially adverse effects on productivity and the capacity to develop and adopt technological innovations.

As we all know, reversing demographic trends is very difficult owing to various cultural, sociological and economic reasons; and, in any event, any policy along these lines requires

time to produce appreciable effects. Accordingly, without abandoning policies in the medium and long term that seek to alter or alleviate such adverse demographic trends, in the short term the means of tackling the situation involves growth in employment and productivity. There is no better or more effective policy in the short term for addressing the impact of population ageing and of scant population growth on pensions than to stimulate employment and enhance the system's overall productivity.

Thank you very much.