

# **ANNUAL REPORT 2015**

## **CHAPTER 2**

# **COMPETITIVE ADJUSTMENT AND RECOVERY IN THE SPANISH ECONOMY**

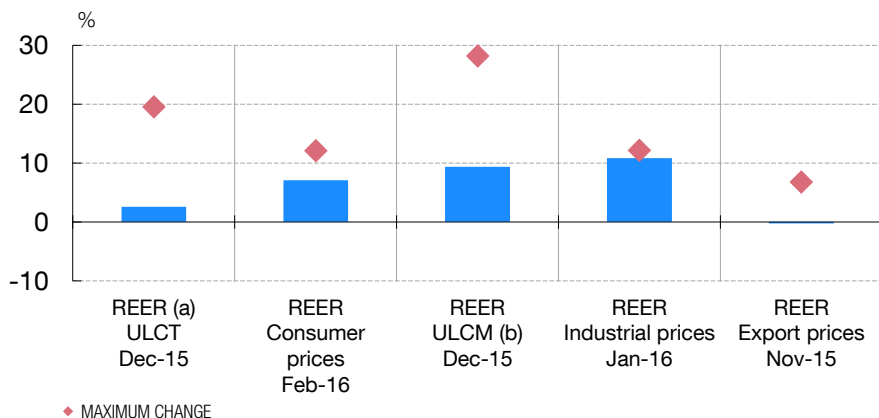
# THE RECOVERY IN COMPETITIVENESS



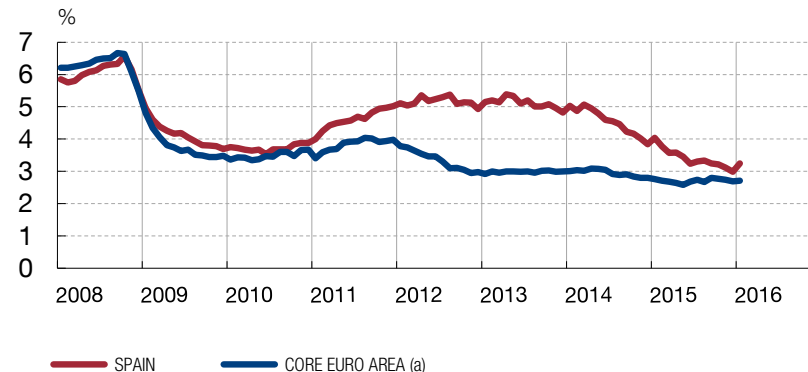
There has been a significant improvement in price/cost competitiveness since 2008, although the magnitude varies according to the indicator considered, with ULCs showing the largest correction.

The competitiveness gains were reinforced by the improvement in financing conditions from 2013.

**INDICES OF COMPETITIVENESS VIS-À-VIS THE EURO AREA**  
Percentage change since 1998



**INTEREST RATES ON LOANS OF LESS THAN ONE MILLION EURO**



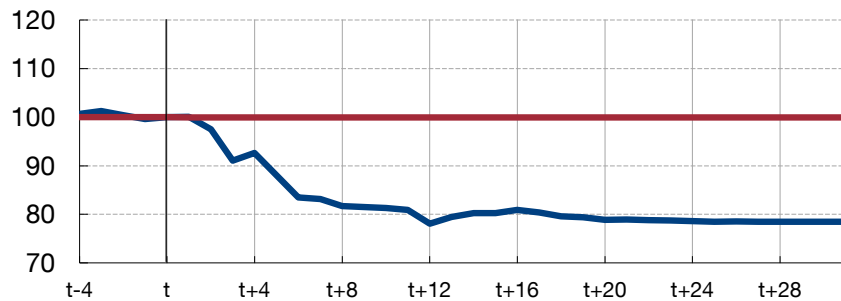
**a** Core euro area consists of: Germany, Austria, France, the Netherlands, Finland and Luxembourg.

# THE INTERNAL DEVALUATION

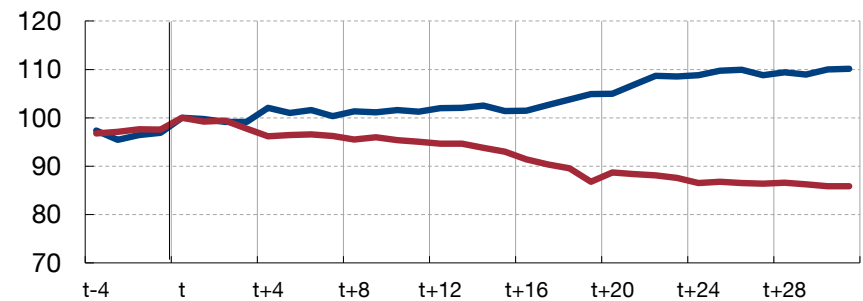


In comparison with the REER adjustment of the 1990s, the current process is based on the gradual adjustment of relative costs and shows a higher degree of persistence.

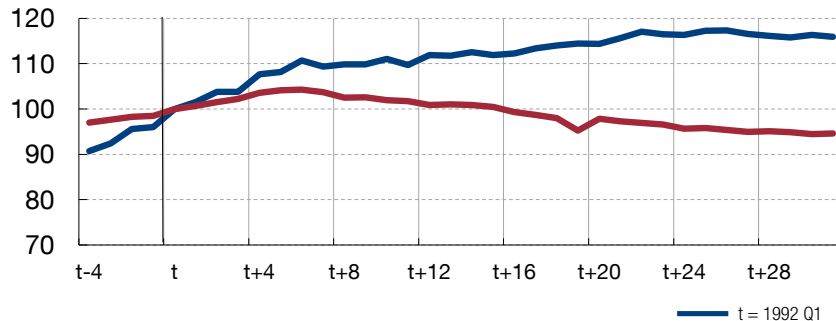
**NOMINAL EFFECTIVE EXCHANGE RATE (t = 100)**



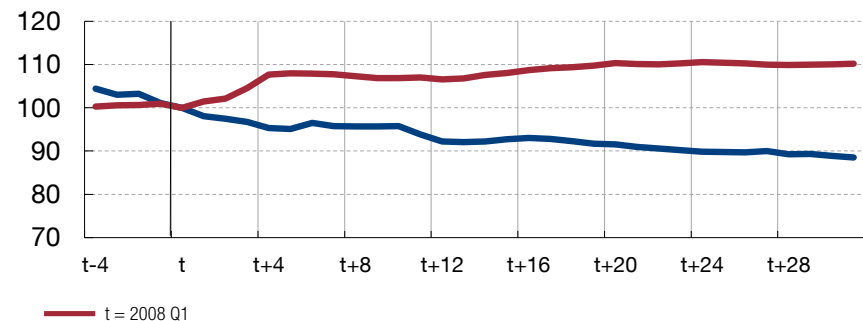
**RELATIVE UNIT LABOUR COSTS (t = 100)**



**RELATIVE COMPENSATION PER EMPLOYEE (t = 100)**



**RELATIVE PRODUCTIVITY PER EMPLOYEE (t = 100)**

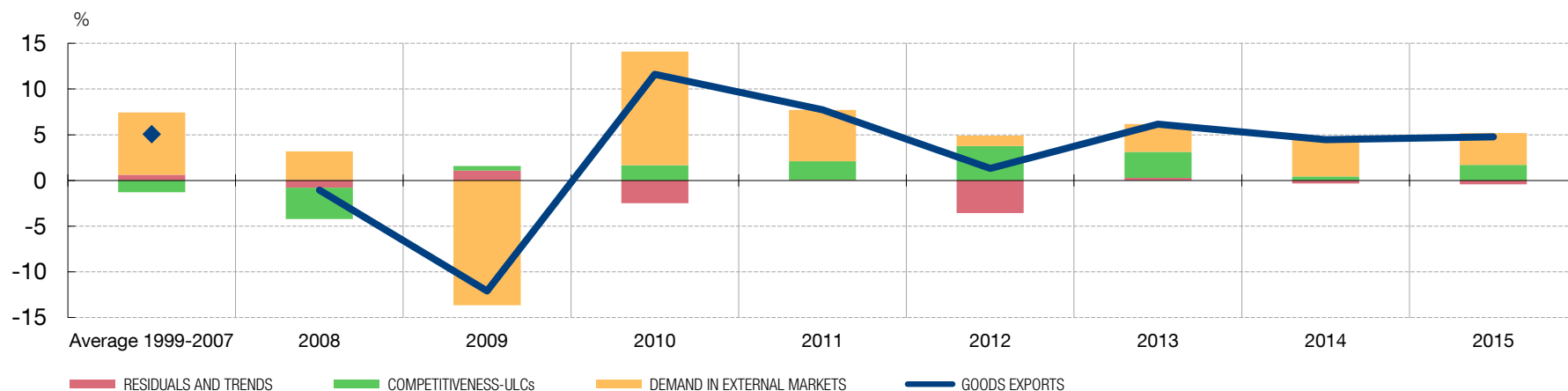


# EXPORT DYNAMISM (I)



The high export growth since 2010 has been based on the competitiveness gains.

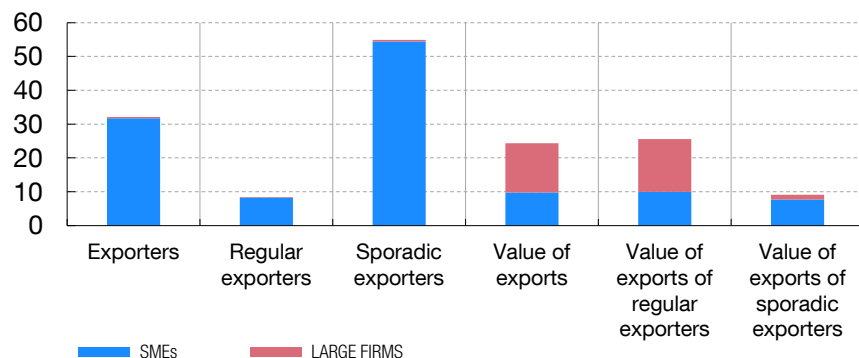
**GOODS EXPORTS AND THEIR DETERMINANTS (AVERAGE COMPETITIVENESS BASED ON UNIT LABOUR COSTS)**



## EXPORT DYNAMISM (II)

The improvement in competitiveness has permitted a clear increase in the export base, partly attributable to SMEs that have begun exporting for the first time.

**CONTRIBUTIONS OF SMEs AND LARGE FIRMS TO THE EVOLUTION OF THE EXPORT BASE AND OF EXPORTS**  
Changes from 2010 to 2013



**RELATIONSHIP BETWEEN EXPORTS AND CHANGE IN LABOUR AND FINANCIAL COSTS AT THE FIRM LEVEL**

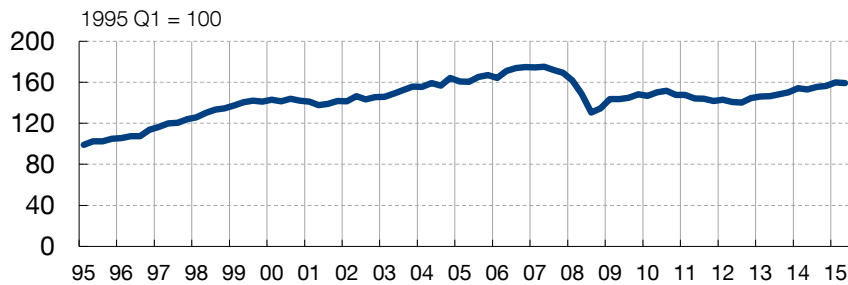
Regressors	Dependent variables		
	Exports (year-on-year growth rate)		
	2002-2013	2002-2007	2010-2013
ULCs (year-on-year growth rate)	-0.58***	-0.55***	-0.63***
Financial costs (year-on-year growth rate)	-0.36***	-0.72***	-0.40***
	Probability new exporting firm		
ULCs (year-on-year growth rate)	-0.2***	-0.2***	
Financial costs (year-on-year growth rate)	-	-1.2	
SMEs	-2.4***	-1.9***	

# IMPORT SUBSTITUTION



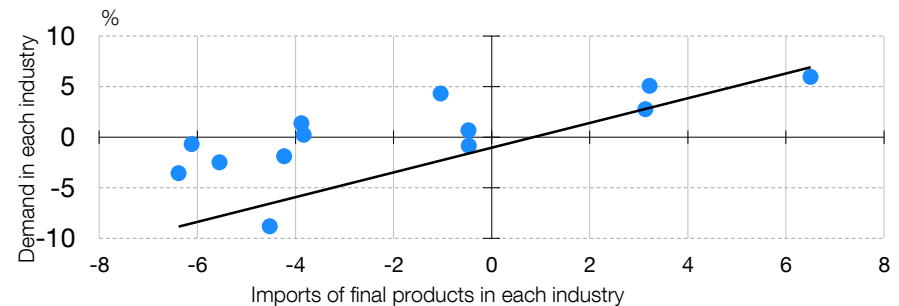
After the cyclical adjustment at the beginning of the crisis, imports picked up strongly in line with final demand. That said, there are some signs that imports may be beginning to show greater sensitivity to changes in competitiveness.

**RATIO OF IMPORTS TO GDP. SPAIN**

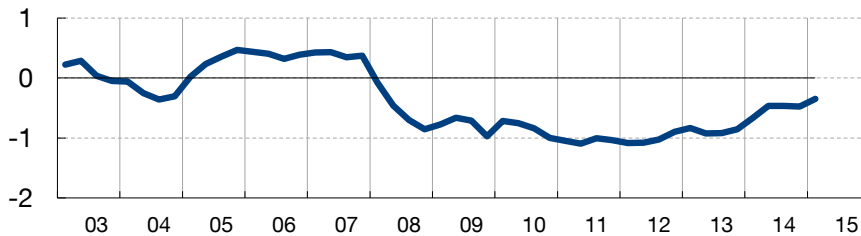


**CORRELATION ACROSS INDUSTRIES BETWEEN DEMAND AND FINAL PRODUCT IMPORTS**

Rates of change in the post-crisis period (2009-2013)

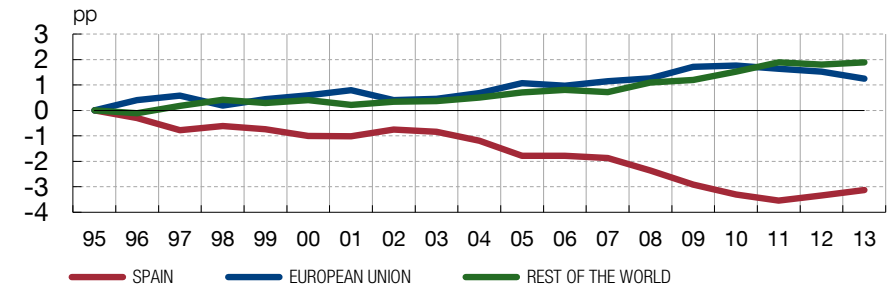


**PRICE ELASTICITY (LONG-TERM)**



**DISTRIBUTION OF INPUTS USED BY SPANISH FIRMS ACCORDING TO THEIR GEOGRAPHICAL ORIGIN**

Evolution of differential since 1995

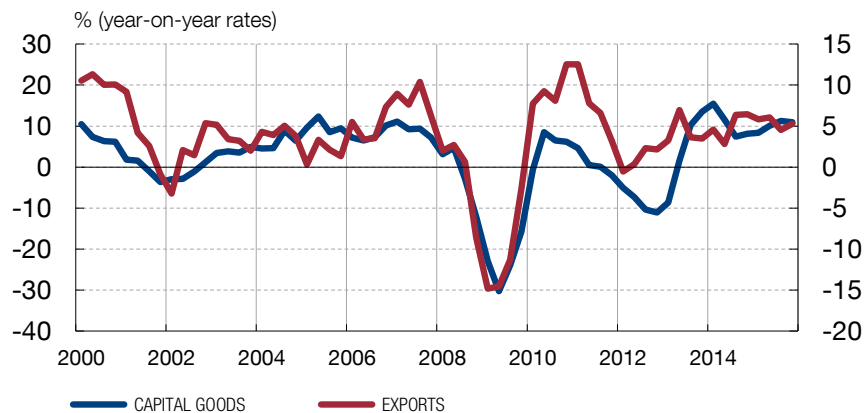


# THE RECOVERY IN PRIVATE DOMESTIC DEMAND (I)



The strong recovery in investment is closely associated with the buoyancy of exports and the improvement in firms' financial position.

**RELATIONSHIP BETWEEN INVESTMENT IN CAPITAL GOODS AND EXTERNAL DEMAND**



**IMPACT OF FINANCIAL POSITION OF FIRMS ON THEIR RATES OF INVESTMENT AND EMPLOYMENT LEVELS**

	Impact on the rate of investment		
	Profitability <sub>t-1</sub>	Debt <sub>t-1</sub>	Debt burden <sub>t-1</sub>
Profitability <sub>it-1</sub> year <2008; >2012	0.162***		
Profitability <sub>it-1</sub> 2008-2012	0.158**		
Financial pressure <sub>it-1</sub> >p75; year <2008; >2012		-0.024	-0.011**
Financial pressure <sub>it-1</sub> >p75; 2008-2012		-0.066***	-0.014***

The decline in the cost of lending is estimated to have boosted business investment by 4% over the period 2014-2015.

# THE RECOVERY IN PRIVATE DOMESTIC DEMAND (II)

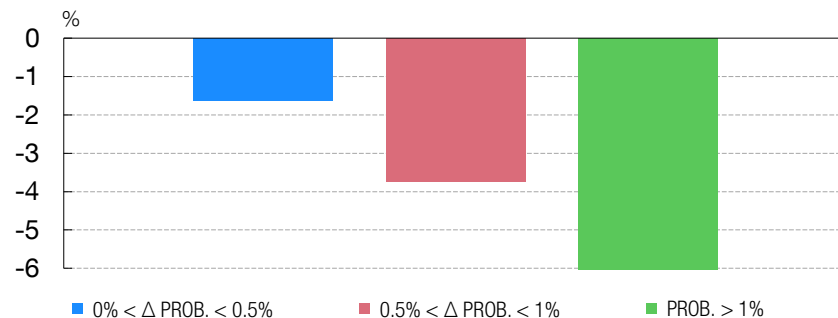


The recovery in employment, supported by the greater wage moderation observed since 2012, has permitted a notable rebound in private consumption, linked to the reduction in precautionary saving owing to the improved labour market outlook.

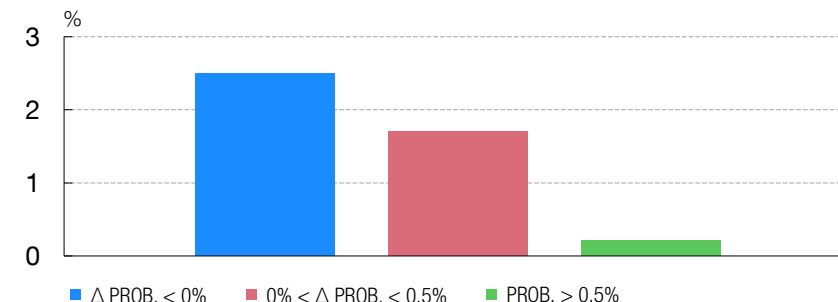
## CONSUMPTION AND EMPLOYMENT



## RATE OF CHANGE OF CONSUMPTION (according to changes in the probability of losing job). 2009



## RATE OF CHANGE OF CONSUMPTION (according to changes in the probability of losing job). 2014





## CONCLUSIONS



The competitive adjustment is relevant to explain the recovery of the Spanish economy.

- The positive impact of competitiveness gains on the economy's external imbalance has essentially stemmed from their ability to stimulate exports.

The recovery originated from external demand and subsequently extended to the spending of domestic private agents.

- The recovery in external demand has been passed through to domestic spending components, boosting business investment and employment. The demand for labour has benefited, in turn, from the greater ability to align labour costs with cyclical conditions, and this has underpinned the recovery in consumption.

## CONCLUSIONS

The observed competitive adjustment is an element underpinning the medium-term outlook, but the process is far from complete.

- The external surpluses attained have been partly based on temporary developments. The improvements in cross-border flows have still not been sufficient to bring about a significant decline in net indebtedness to the rest of the world, which represents a source of vulnerability.

The remaining challenges must be addressed through an ambitious reform agenda.

- For the simultaneous achievement of external surpluses and further reductions in unemployment the competitive advantages achieved in recent years must be sustained.
- From a long-term perspective, lasting competitive advantages must stem from productivity increases that, in turn, arise from structural labour and product market reforms.