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The current economic environment: challenges and opportunities*

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* English translation from the original in Spanish.

Distinguished Rector, Rosa Bolea; distinguished Dean of the Faculty of Economics and Business, Ana Yetano, professors, ladies and gentlemen:

I wish to thank the Faculty of Economics and Business of the University of Zaragoza, and the Garrigues Chair in Law and Business, represented here today by Juan Luis Falcón, for the opportunity to participate in this conference marking the faculty's 50th anniversary.

Today I shall analyse the current economic climate, clearly shaped by the uncertainty that has surrounded us in recent years.

In an economy as interconnected as ours, it is fitting to begin with a few remarks about the international environment.

In 2024 the world economy showed remarkable resilience, with estimated growth of 3.3%, against a backdrop marked by buoyant activity in the United States and a strong services sector.

In the euro area, economic activity grew by 0.8% in 2024 (0.5% in 2023), albeit with significant cross-country heterogeneity. The modest acceleration in economic activity was mainly underpinned by growth in government expenditure and a positive performance from the external sector. At the other end of the spectrum, persistently high uncertainty hindered a stronger recovery in private consumption.

Some central and northern European countries, such as Austria, Finland and Germany, where the industrial sector accounts for a relatively large share of the economy, experienced a slight contraction in GDP, partly due to the fall in productive investment. Conversely, some southern European countries, such as Spain, Greece and Portugal, more specialised in services related to trade, transport and tourism, recorded higher GDP growth rates.

However, in the final stretch of 2024 and early 2025, we have seen uncertainty grow as a result of heightened geopolitical and trade tensions, largely associated with the various measures announced and/or introduced by the new US Administration.

The new situation prompted a sharp slowdown in the first quarter of 2025. Indeed, in the United States, quarter-on-quarter GDP growth declined from 0.6% in the fourth quarter of 2024 to a contraction of 0.1% in the first three months of 2025, chiefly as a result of the rise in imports in anticipation of the tariff hikes and weaker private consumption.

By contrast, in other economies, such as China, GDP growth of 5.4% outpaced expectations, due to the effect of the stimulus measures deployed by the Chinese authorities and exports (as a result of the frontloading of trade flows ahead of the tariff hikes). In the euro area, economic activity also surprised on the upside in the first quarter, with quarter-on-quarter growth rising to 0.4% from 0.2% at year-end. It is also encouraging that the region's two largest economies, France and Germany, returned to rising growth rates.

Looking at prices, inflation in general continued to ease gradually at the global level, despite volatile energy prices and the downward stickiness of services inflation.

Headline inflation remained on a downward path in the euro area, standing at 2.4% in December 2024. This decline owed mainly to developments in the most volatile inflation

components, notably the strong moderation in food and energy prices. In terms of inflation there was less cross-country heterogeneity.

In late 2024 and early 2025, the downward trend in global inflation stalled, mainly as a result of rising energy prices. More recently, however, these have fallen significantly (particularly oil prices), largely due to uncertainty and a worsening economic outlook.

Core inflation also decreased to 2.7% in 2024, influenced by greater downward stickiness than expected in services inflation. By contrast, non-energy industrial goods prices moderated significantly as a result of the gradual easing of the global value chain bottlenecks and the correction in energy input and commodity prices.

In recent months, the global environment has been marked by mounting economic policy uncertainty and heightened geopolitical and trade tensions. The inflation outlook is extraordinarily uncertain and will be determined by how the current trade tensions unfold, the performance of financial markets, the possible emergence of bottlenecks, and the degree of economic agents' confidence and certainty.

The “reciprocal tariffs” announced by the US Government triggered an episode of severe financial turmoil globally, which has been reversing in recent weeks but continues to leave global financial markets exposed to potential adverse shocks in the coming months. Some risky asset prices remain high by historical standards.

Turning to Spain, the economy was notably buoyant in 2024, surpassing projections and the average growth rate of the euro area. The salient factors underpinning GDP growth in Spain were strong public and private consumption – compared with relatively weak investment – and the positive contribution of net exports, which was shored up by the sound performance of travel and non-travel services exports.

Industry, which has benefited from more competitive energy prices, has been a driving force. Tourism-related activities have been boosted by growing diversification, both across seasons and in terms of source and destination countries. Lastly, in non-travel services, which have seen an across-the-board increase in services being provided online, employment has surged in tech-intensive sectors such as programming, IT consultancy and information services, possibly reflecting Spain's strengths in terms of digital infrastructure.

Household consumption explained half of the increase in activity in 2024, buoyed by population growth, lower interest rates and higher real income. However, amid persistently high interest rates and rising uncertainty, household consumption increased less than household income, prompting a fresh rise in the saving rate. Although the saving rate is still lower than in the euro area, it was almost 5 percentage points (pp) higher than its pre-pandemic historical average.

Over a longer time frame, since 2019, the increase in aggregate household consumption has barely offset the demographic growth of the Spanish economy. Thus, at end-2024, consumption per capita remained slightly below its pre-pandemic level, unlike in the euro area.

Moreover, household borrowing continued to decline. The debt-to-income ratio was 68% at end-2024, a level not seen since 2000 and 15 pp below that of the euro area. The proportion of highly indebted households has decreased as a result of lower indebtedness and reduced interest rates. The estimated percentage of households with a debt burden

exceeding 40% of their income fell to 7.4% in 2024, more than 3 pp below the average for 2014-2022.

Turning to non-financial corporations, the ratio of debt to profits held stable at low levels despite a growing stock of debt, while they also benefited from lower interest rates.

Government consumption remained strong in 2024, growing at a quicker pace than observed in the euro area. Since late 2019 this demand component has established itself as the main contributor to cumulative GDP growth, accounting for around half of output growth over this period.

Gross capital formation, together with goods exports, remains the demand component which has been slowest to recover since the health crisis. By component, investment in capital goods and investment in construction other than housing show the greatest weakness relative to pre-pandemic levels. Meanwhile, residential investment recorded modest growth last year. Once again, this growth was insufficient to meet the increasing need for housing that has arisen in recent years, partly driven by a higher number of households.

Other key drivers of GDP growth in 2024 – and in recent years more broadly – were the expanding population and employment growth, which has led to a protracted decline of the Spanish economy's high unemployment rate.

Job creation has been largely concentrated in the immigrant population, among workers with higher levels of education and, in terms of sectors, in services, some of which have high added value. At the same time, there are growing signs of labour market tightening, with a rising percentage of firms reporting that labour shortages have restricted their activity.

The unemployment rate in Spain fell from 12.2% in 2023 to 11.3% in 2024, still around 5 pp above the EU average. Since the outbreak of the pandemic unemployment rates have declined most sharply in precisely those regions that have traditionally had the highest jobless rates. In any event, regional dispersion in unemployment rates is relatively high in Spain compared with other European countries.

Productivity gains also seem to have boosted GDP growth. For instance, in both 2024 and in the period 2019-24 productivity grew more robustly in Spain than in other euro area countries, especially compared with France and Germany and in terms of total factor productivity. Nonetheless, the negative productivity gap built up over recent decades between Spain and other euro area economies is still significant. Narrowing it remains a key challenge for the Spanish economy.

Another point to mention is that the budget deficit shrank from 3.5% of GDP in 2023 to 3.2% in 2024.¹

The budget deficit reduction in 2024 was helped by government revenue exceeding expenditure.

¹ 2.8% excluding costs associated with the flash floods in Valencia.

Against this backdrop, Spain's public debt-to-GDP ratio fell from 105.1% in 2023 to 101.8% in 2024, driven by nominal GDP growth. However, the ratio remains one of the highest in the euro area and is still 4.1 pp above where it stood at end-2019, before the pandemic.

In short, activity in recent months has been shaped by economic policy uncertainty and geopolitical and trade tensions. The United States' erratic and arbitrary tariff policies cast a shadow over a highly unpredictable landscape and will certainly affect the economic outlook. Furthermore, although the latest data show no significant change in the disinflation process, the climate of uncertainty could still produce wide-ranging effects.

In terms of the future outlook and challenges, in such a complex environment with so many uncertainties it is imperative to consider various hypothetical scenarios. For instance, the simulations conducted by the Banco de España suggest that a potential tariff hike would adversely affect the level of global activity. This impact would be particularly pronounced in the United States but more moderate in the euro area, especially in Spain. However, if these trade tensions were amplified by a deterioration in global financial conditions or uncertainty levels, the negative impact on the Spanish and European economy's GDP would be greater.

In any event, looking further ahead, it is important to understand the deeper and more structural questioning of multilateralism in international relations and of globalisation, and to assess the possible implications of these developments in the long term. Specifically, any intensification of the doubts that have emerged recently over the dominance of the US dollar in the international monetary and financial system could trigger significant risks to global financial stability.

Turning to Spain, first it is essential to analyse how much of Spanish economic activity's recent dynamics is attributable to purely conjunctural factors (and could therefore unravel in the future) and how much owes to truly structural changes (which have sustainably increased the Spanish economy's resilience and growth capacity).

Second, despite some notable headway recently, the Spanish economy still faces numerous extraordinarily important structural challenges. Some of these challenges have been well known for decades (such as those related to productivity and the labour market), while others, for example those linked to the housing market, migratory flows and climate change and the green transition, have gradually come to the fore in recent years.

In addition, amid growing pressures on the expenditure side, complying with the new European fiscal rules will require rigorous planning, with an eye on the medium term, to simultaneously bolster the sustainability of public finances and improve their composition, so that government budgets are more growth-friendly.

Against this economic background, Spain's banking sector has also performed well. For instance, consolidated net profit grew by 21% in 2024, with a return on equity of 14.1%. Profitability has improved in both business in Spain and business abroad. This owed to strong net interest income, which, despite cuts in reference interest rates, rose by 9% compared with the previous year. Lending also contributed, with moderate growth in 2024 (0.8%) following several years in decline. The growth in corporate credit was driven by large firms, while that in lending to households was led by both consumer lending and housing loans.

Fees and commissions, as well as gains on financial assets and liabilities, also helped to boost profitability.

Strong employment and robust corporate earnings in 2024 were conducive to impairment losses expanding at a slower pace than net operating income. The non-performing loan ratio is historically low, while stage 2 loans also decreased significantly.²

All this has seen Spain's banking system consistently outperform those of other major EU countries in terms of profitability.

And where have banks allocated some of these profits?

First, to profit distribution through dividends and net purchases of own shares, which increased in 2024. Indeed, in 2024 profit distributed to shareholders as a share of risk-weighted assets (RWAs) climbed to 1.1%, the highest value in recent years, making the banking sector more attractive to investors.

Second, to shoring up solvency. At end-2024, the Spanish banking system's CET1 ratio stood at 13.5%, up 30 basis points on the previous year. This increase was due to the 6% growth in CET1 capital in year-on-year terms, which offset the negative contribution from the 3.6% year-on-year rise in RWAs. The RWA growth in 2024 mainly owes to an increase in total assets and, to a lesser extent, their rising risk profile (higher RWA density).

The Spanish banking system's leverage ratio also rose slightly in 2024, to 5.7%.

The system's CET1 ratio remained below that observed for the other main European banking sectors, although the gap narrowed slightly.

Lastly, Spanish banks maintained comfortable liquidity and net stable funding ratios, well above both the regulatory requirement and the average for major European banks.

As we have seen, the Spanish banking sector is in a particularly sound position.

Certainly, we ought to reflect on whether the dynamics behind Spain's economic growth in recent years are conjunctural or structural, implementing any necessary changes to address structural shortcomings. Equally, we must also consider whether our financial system is operating within the best possible framework.

Maintaining strict capital requirements within a sound regulatory and supervisory framework is compatible with simplifying the framework to make it clearer and more predictable. Indeed, we must ensure that implementing Basel III reforms is entirely compatible with a review of the EU regulatory and supervisory framework, seeking to make it simpler, clearer and more predictable without undermining the banking sector's resilience. The simplification process should be holistic, considering the different tiers of the regulatory and supervisory framework (for example, regulatory standards and guidelines) and its various areas (microprudential, macroprudential and resolution).

² 15.6% year-on-year.

All of which would create the optimal conditions for our banks to be both robust and efficient, driving the changes that our economy needs both from a sustainability and competitiveness standpoint. We can expect much debate about these two interconnected aspects today.

Thank you.