

Luis M Linde: The Spanish economy – situation and outlook

Speech by Mr Luis M Linde, Governor of the Bank of Spain, at the XIV Día de los Economistas 2015, organised by the Colegio de Economistas de las Islas Baleares, Las Palmas, 30 November 2015.

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Let me first thank Mr Onofre Martorell, the dean-president of the Balearic Islands Association of Economists, and Mr D. Valenti Pich, the president of the General Board of Economists' Associations, for their invitation to this event, and Professor Guillem López Casanovas, too, for his kind words of introduction.

I shall begin by talking about the international and European economic setting, moving on to the Spanish situation and our growth projections. I shall also briefly refer to developments in the external sector, in general, and to tourism, which is so important for our economy and, naturally, for the Balearic Islands, in particular. I shall conclude with some remarks on the Spanish banking system and the challenges the Spanish economy faces.

International setting

Recent developments in the international environment have been marked by greater uncertainty over global growth (due largely to the slowdown in the emerging economies), the fall in oil and commodities prices, and the increase in volatility on financial markets, linked to expectations about interest rate rises in United States and to the revision of global growth forecasts.

In its latest report the International Monetary Fund lowered its estimate for world growth for 2015 by 0.3 pp to 3.1%, with the developed and emerging economies expected to perform differently.

The pick-up in activity continues in the advanced economies, underpinned by favourable financing conditions and low commodities prices, while inflation is running at very low rates.

In most of the emerging economies, activity continues to fall, owing not only to conjunctural reasons in the international environment, but also to more structural factors, such as lower productivity gains and demographic factors. Activity continued to slow in the emerging Asian economies, while in Latin America it is stabilising at very low rates, albeit with notable differences from country to country; in turn, in some cases, inflation stands above the authorities' targets, due partly to the depreciation of their currencies.

Of particular significance for the world economy are the developments in China, which posted an annualised rate of GDP growth of 6.9% in the third quarter. That entails a slowdown, but one milder than anticipated. However, uncertainty over its medium-term growth rate persists bearing in mind the authorities' intention to lead the Chinese economy towards a more sustainable and more domestic consumption-led model.

The consequences of the slowdown on the world economy, mainly via the effect of the decline in commodities prices on exporting countries' economies, are so far projected to be limited.

The euro area

The moderate recovery in activity continues in the euro area, underpinned by the expansion of private consumption, against a more uncertain external background for industrial production, exports and business investment.

In the third quarter, GDP growth in the area was 0.3%, 0.1 pp down on the second quarter. The buoyancy of private consumption and the somewhat more expansionary behaviour of investment were the main factors behind this performance. Growth projections for 2015 by the main international agencies stand at around 1.5%.

The Spanish economy

The expansion in the Spanish economy extended into the third quarter of 2015, with Spain notably one of the highest-growth economies in the euro area.

On the latest National Accounts data, GDP grew in the third quarter of this year by 0.8% in quarter-on-quarter terms, with the year-on-year rate standing at 3.4%. This increase in activity appears to be underpinned by the strength of private domestic demand, while the contribution of the net external balance is estimated to be moderately negative, albeit against a backdrop of quickening quarter-on-quarter rates in both exports and imports.

Household spending is notably buoyant, on the back of the favourable trend in employment, improved financing conditions, the expansion in real disposable income attributable to the fall in oil prices and the recent fiscal measures.

Business activity is expected to have continued improving during the third quarter, driven by the strength of final demand and favourable financial conditions. The business investment indicators have also remained generally firm throughout 2015.

Allow me now briefly to address employment, the external sector, growth projections and the factors of risk for our economy in 2016. And before drawing conclusions, I shall also refer to the strengths of our banking system and the challenges facing it.

Employment

The employment figures remain on a positive path.

According to official labour force survey figures, numbers employed grew by 182,000 in the third quarter, placing the cumulative figure over the past 12 months at 545,000 people. This figure entails an annual growth rate of 3.1%. Social Security registrations, for their part, increased at a year-on-year rate of 3.2% in October, the same rate as the previous month, with registrations up 530,000 compared with the same month a year earlier.

The unemployment rate in the third quarter stood at 21.2%, down 2.5 pp in the past 12 months. On our projections and those of the IMF, it is within our reach by the end of 2016 to bring the unemployment rate below 20% for the first time since 2010. These figures, though they attest to the improvement in the labour market, are still very high, abnormally so in the context of the euro area. They show the need to maintain a high rate of activity and to continue streamlining our labour market to prevent the combination of low activity and inadequate regulations, as so often occurred in the past, from driving job destruction.

Balance of payments and tourism

Our balance of payments performance in the past three years has been very favourable: from running a heavy deficit, with a negative current account balance up to 10% of GDP in 2007, we are now in a different position, with few, but brief precedents in Spanish economic history, marked by a current account surplus against a background of significant GDP growth and job creation.

In the first nine months of this year (the figures for September were published today), the Spanish economy's net lending (i.e. the cumulative surplus on the current account balance and the capital account balance) stood at €13.2 billion, compared with a surplus of €5.8 billion in the same period of 2014; that is to say, it has more than doubled thanks to the reduction in net foreign interest payments. The widening of the surplus on capital account and the increase in the positive balance on goods and services, as a result of the improvement in the energy balance and, to a lesser extent, in the surplus on non-tourist services, were also a contributing factor.

The tourism balance has contributed positively to the improvement in the current account balance. In the January-September period, the tourism surplus was €28.4 billion, a very similar figure to that recorded in the same period in 2014.

According to surveys by the IET (Institute for Tourism Studies), the Balearic Islands was the second-ranked Spanish region in terms of incoming international tourists and of their expenditure, with almost 10 million visitors from January to September 2015 and with receipts of around €10 billion.

Forecasts

Let me move on now to our growth forecasts.

The latest Banco de España projections, released in September, place the increase in GDP at 3.1% for 2015 as a whole, and at 2.7% for 2016, in line with those drawn up by the main international agencies and by private analysts. This growth is forecast to be underpinned by national demand, with moderately negative contributions by net external demand.

Among the components of national demand, household consumption is expected to continue to be highly dynamic, supported by the favourable labour market performance and driven by the expansionary impact on disposable income of the fall in oil prices, the reduction in direct taxation and the refund of the “extra” December salary payment to public-sector employees. The current recovery in investment in construction is expected to run further, against a backdrop of improved financing conditions, while business investment will continue to post high rates of increase, in line with the strength of final demand.

As regards foreign trade, there will be modest increases in exports, in a setting in which the improvement on euro area markets and the achievement of further gains in competitiveness are expected to be partly offset by the slowdown in other foreign markets. Imports will remain notably buoyant, in line with the strength of final demand.

This dynamic activity will provide for continuity in employment creation, to which the moderation in labour costs will prove conducive, and, as I stated earlier, it will allow the unemployment rate to continue falling.

Factors of risk

The main risks for the Spanish economy from the external environment are associated with the possibility of a sharper-than-expected decline in the emerging economies. Within the Monetary Union, headway in institutional architecture and the agreements reached with Greece have lessened financial tensions in the area.

On the domestic front, the main risk is the possible influence of the uncertainty surrounding medium-term economic policy developments on agents’ spending decisions. In particular, these risks are associated with the possibility of a loss of confidence due to the exhaustion of or slippage in the reform process, or to the non-fulfilment of fiscal consolidation commitments, given that these have been the pillars upholding the adjustment of the Spanish economy, the pick-up in competitiveness vis-à-vis the euro area members as a whole and, in short, our economic recovery.

The challenges to and strengths of the banking system

Turning to the situation of our banking system, I would firstly like to highlight the efforts Spanish banks have made to improve their solvency. These have taken the form not only of enhanced capital ratios, regardless of the solvency ratio used, but also of an increase in the absolute volume of own funds.

The consolidated profits of Spanish banks in the first half of 2015 also contributed to this strength, amounting to €12.59 billion, 37% up on the previous year.

The improvement in the consolidated result has also translated into a rise in profitability ratios, both in terms of assets (ROA) and equity (ROE). However, this improvement was mainly underpinned by activity abroad, the weight of which in the total business of Spanish deposit institutions increased compared to domestic business. The return on equity (ROE) has resumed positive levels, around 5%, though we are still some way off average historical levels and it should be noted they are below cost-of-capital estimates.

In a setting characterised by the persistence of very low interest rates, one of the main challenges banks face is to maintain adequate profitability levels, especially at a time when the dynamism of banking activity is still limited and the volume of non-performing loans (NPLs) and foreclosures remains high. But we should highlight here the adjustments banks have been making to the volume of NPLs and foreclosures, which have been declining continuously since early 2014.

Final remarks

The Spanish economy is overcoming the most serious crisis, I would say, without fear of exaggerating, of those it has experienced in recent decades since the 1959 Stabilisation Plan – almost 60 years ago – paved the way for strong development and for reforms that gave momentum to our integration into the international economy.

This crisis has had very serious consequences: the loss of activity, of income and of wealth, the high levels of private debt, the increase over very few years and by more than 60 pp of GDP in public debt, and the highest unemployment levels in the whole of the EU. These consequences are not behind us, and it will take some time yet to eradicate them.

But our economy today is one of the most dynamic in the euro area and in the European Union as a whole. The forecasts available indicate that this strong growth, with a healthy balance of payments position and strong net employment creation, may continue in 2016, though there are external and domestic risks that might upset this prospect.

We must build on the reforms undertaken and continue redressing the accumulated imbalances, among which the high level of unemployment and high debt are unquestionably the most serious, without forgetting the need to push through and fulfil the fiscal consolidation commitments required within the European Union.

Thank you very much for your attention.