

Luis M Linde: The European and Spanish economic situation

Opening address by Mr Luis M Linde, Governor of the Bank of Spain, at the Annual Economists' Forum/Consejo General de Economistas, Madrid, 29 May 2014.

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I much appreciate the invitation to participate in this forum and the opportunity to share with you some brief thoughts on the European and Spanish economic situation.

Following six quarters of negative growth, the euro area economy initiated a mild recovery in 2013 which has since continued. The recovery is essentially being underpinned by the gradual pick-up in domestic demand, after the strong adjustment it underwent during the recession.

However, the latest GDP growth figure, for the first quarter of this year, illustrates the still-fragile and uneven nature of this economic improvement in the euro area.

According to the provisional estimate released by Eurostat, the increase in activity in the euro area as a whole in 2014 Q1 was 0.2% in quarter-on-quarter terms, below most analysts' expectations. Note that this rate has been affected by exceptional temporary factors in some countries. In any event, the mixed nature of the recovery is evident if we compare the strong momentum the German economy is providing to the area as a whole with the behaviour of activity in other countries such as France, where it is practically flat, or others still such as Italy, the Netherlands, Portugal and Finland, where negative figures have been posted.

The ECB and the National Central Banks of the Eurosystem are finalising a new projection exercise, whose results will be published in early June. That will be the time to assess the effects that this first-quarter figure and all the new information compiled since the last exercise may have exerted on the baseline scenario for GDP growth in the coming quarters. As you know, in any event, the procedural rules for the ECB Governing Council set a brief period immediately before each of the monetary policy meetings in which the members, myself among them, must not make any statement that may be interpreted as pre-judging in any way the outcome of the meeting. You will therefore understand if I abstain from making any further assessment in relation to this scenario.

In terms of employment, last year also saw a turnaround and the job destruction phase in the euro area touched bottom in the second quarter. But the still-moderate recovery has not yet provided for significant improvements in employment levels, meaning that hours worked in the labour market remain far below the historical average and unemployment rates are at a high.

On the prices front, sluggish demand and labour market slack are strongly influencing area-wide inflation developments. The growth rate of the Harmonised Index of Consumer Prices has stood at a level below 1% since October 2013, with figures that have generally tended to surprise on the downside. As in the case of activity, the results of the projection exercise under way will allow for calibration of the effects on the current price scenarios and, in particular, on the risk – flagged by the ECB Council at its recent meetings – that the area may become immersed in a prolonged period of too-low inflation.

Turning to the Spanish economy, we are all mindful that the crisis that broke in mid-2008 was of unprecedented depth and extent in our recent history and caused acute losses in activity and employment. Fortunately, since the second half of 2013, the Spanish economy has perceptibly been experiencing a recovery, which began with positive, moderate quarter-on-quarter rates of change in GDP as from 2013 Q3 and which has continued in 2014 to date.

This recent improvement in activity rests on a broad set of factors: some, such as the drastic correction of the external imbalance, have been helping underpin production for some time; others, such as the progressive normalisation of the financial environment, are more recent.

Here, both the easing of grave uncertainty, which at one point threatened the current configuration of the euro area, and the restoration of confidence in our banking system following the restructuring and recapitalisation drive undertaken, which culminated in January, have proved decisive.

Against this background, the contributions to activity of external demand and national demand are being re-balanced. National demand is showing a brisker pace of recovery than initially envisaged, based on the increase in household consumption and investment in equipment over the past two quarters, and on some slowing in the fiscal adjustment following the revision of the adjustment path last summer.

In fact, household spending, in a setting of improved confidence resulting largely from the gradual improvement in the labour market and from some recovery in disposable income, is showing moderate growth, despite the fact that the necessary reduction of household debt is still exerting something of a contractionary effect on expenditure. Further, investment in capital goods is looking buoyant, in light of the improved business climate and increased investment activity by exporting firms. The contractionary course of residential investment has slowed, although it remains in negative territory, while the stock of unsold housing remains high.

The outlook of progressively improving activity is closely linked to labour market developments, where the benefits of wage moderation and the improved incentives for job creation driven by the recent labour reform are becoming patent. The latest employment figures show a continuation of the positive trend discernible since the second half of 2013. Thus, in recent months, Social Security registrations have continued to increase and the pace of decline of registered unemployment has stepped up. However, on the first-quarter figures for 2014, the unemployment rate remains very high, still close to 26% of the labour force.

The rate of inflation has been posting very moderate figures since autumn last year as a result of the removal from the index of the base effects linked to fiscal consolidation; certain temporary factors, such as those relating to energy price developments; and other more durable factors, relating to the economy's excess capacity, the reduction in unit labour costs and the relative sluggishness of spending. For the remainder of the year the inflation rate is expected to hold at low levels, below the euro area average, thereby permitting further headway in gains in competitiveness with which to entrench a stronger recovery. Low inflation is conducive to gains in income purchasing power, although the counterpoint to this is the greater difficulty this adds to further progress in household and corporate deleveraging.

In the more immediate future, the advances made by the Spanish economy augur a firming of the gradual path of recovery, underpinned by greater confidence, a progressive easing in financial tensions and a gradual improvement in the labour market. A crucial role will have to be played here by the re-balancing processes under way in the Spanish economy, especially the redressing of the private sector's financial position and fiscal consolidation. The successful culmination of these processes is pivotal for rooting the recovery in domestic and external confidence and for ensuring the external funding flows that are vital for making sustained medium-term growth possible.

In sum, for the first time after years of crisis, we can discern the possibility of a gradual and sustainable recovery, the outcome of the progress made in correcting the imbalances that we had built up and of the structural reforms undertaken, whose results we are beginning to see. The task is not complete and much work remains to be done, both in Europe and in Spain. Hopefully, however, the progressive perception of the improvement achieved will act as a powerful spur for us to persevere on the road we have taken.