

Luis M Linde: From restructuring to transformation

Speech by Mr Luis M Linde, Governor of the Bank of Spain, at the 6th Financial Meeting “From restructuring to transformation”, organized by Expansión/KPMG, Madrid, 20 October 2015.

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Firstly, thank you very much for the invitation to open this 6th Financial Meeting organised by Expansión-KPMG. This meeting is now a classic in our calendar and always provides the occasion for interesting reflections and discussions.

One year on from the start-up of the Banking Union, the European financial system can be said to have been strengthened, though this clearly does not mean that it is not facing major challenges and problems. I would sum up the key features here in the following six points:

1. First, following the balance sheet analysis and the stress tests of institutions subject to ECB supervision, and the start-up of the Single Supervisory Mechanism, today there is more awareness of Europe’s banking system and of its greater reliability.
2. Second, solvency levels have been shored up: Europe’s banking system is now sounder.
3. Third, in my opinion, is the greater transparency achieved regarding the situation of the major European banks. And this, together with the Single Supervisory Mechanism and the strengthening of solvency levels, has helped pave the way for banking mergers and consolidation, which were far less conceivable before the start-up of the Banking Union.
4. Fourth, alongside the Single Supervisory Mechanism, the Single Resolution Mechanism, the Resolution Board and the Single Resolution Fund are also being created and will likewise be pivotal to the construction of the Banking Union.
5. Fifth, this progress has notably coincided with very low interest rates, increasingly stringent regulatory requirements and strong competition, bringing pressure to bear on profitability. This may lead to attempts to achieve greater profitability at a higher risk, something that the supervisory authorities must monitor closely.
6. Sixth, from the standpoint of banking system users and customers, in the last two years a decline in and the practical removal of financial market fragmentation has been achieved.

For Spain, the latest data indicate that the deleveraging of households and non-financial corporations is continuing, albeit less intensely. At the same time, there is an increase in the number of firms witnessing how their credit volume is growing (currently more than 40% of non-financial corporations are increasing their borrowing). These firms generally have a better balance sheet position and a brighter economic outlook.

The debt-to-GDP ratios of non-financial corporations and households alike have continued to ease and are clearly below the peaks of the previous cycle in 2010, thus bringing Spain’s ratio closer to the average euro area ratio. Although private-sector deleveraging in Spain may yet last for some time, it is reasonable to conclude that most of the adjustment has now been made.

For the euro area as a whole, the gradual improvement in credit aggregates has continued in recent months with an increase, albeit moderate, in the loans extended to financial corporations and households. Across the euro area, the slight easing in lending standards for firms and households can be seen to have continued, with the exception of those for household mortgage loans, whose standards have been tightened owing to the regulatory changes approved in several countries.

In any event, most crucial for how the European financial and banking system will fare in coming years will be the macroeconomic setting. Let me turn now to recent developments in and the outlook for the international and the Spanish economies.

The international economy

International financial and economic developments have been characterised in recent months by heightened uncertainty. The main factors in this connection are: doubts over the intensity of the adjustment of China's economy, and its consequences for international trade and the global economy; the future timing and pace of US monetary policy normalisation; and the course of oil prices.

The global economy has continued to grow, although at lower rates. The projections in the IMF's latest report put global growth at 3.1% in 2015, 0.3 pp lower than in 2014, and 0.2 pp lower than the July projection. Noteworthy is the change in the composition of global growth in response to the slowdown of the emerging economies compared with the greater resilience of the developed countries.

The situation in the United States, where the economy is in a cyclically more advanced position and employment levels are close to their structural low, is conducive to the Federal Reserve normalising monetary policy. However, the absence of inflationary pressure, the downturn in and uncertainty over the global economy, and doubts about when interest rates will begin to rise all cast a shadow which has prompted very mixed expectations.

As for developments in emerging economies, the slowdown in China, sharp adjustments to its share prices and the depreciation of its currency during the summer have heightened the risks of a steeper-than-expected fall in activity, with effects on the global economy through trade and commodity prices and via indirect contagion effects owing to higher risk aversion in international financial markets.

The main issue regarding the Chinese economy is not whether it slows by a fraction of a percentage point more than projected, but rather the external consequences of such a development. For example, a slowdown in growth to around 6% of GDP, compared with 7.3% in 2014, is no grave cause for concern. In principle, these figures, which largely reflect the change in China's production model to an economy more geared towards consumption, can be managed by the authorities. The uncertainty lies in the difficulty of evaluating the external effects of such changes, and the fact that the differing forecasts of private and public agents are reflected in greater volatility in financial markets.

Asian and Latin American emerging economies are particularly sensitive to changes in the international arena. In Latin America, GDP data for the second quarter show a significant slowdown. The Brazilian economy, in particular, is worrying given its high budget deficit and significant current account shortfall (although the latter has begun to be corrected), along with inflation that needs to be contained and corrected as soon as possible. The IMF projects Brazilian GDP will fall by 3% this year and will fall further, albeit moderately, in 2016.

I would like to indicate that the impact of the downturn in the emerging economies on Spanish banks, even for those with significant exposure to some of these economies, has been moderate. The geographical diversification of their businesses and the adjustments made to their management have contributed to the stability of their balance sheets.

Developments in the euro area

As for economic developments in the euro area, growth in the second quarter was external demand-led, although internal demand continues clearly to support disposable income arising from lax monetary policy, the neutral fiscal policy stance, low energy prices and the improvement in the labour market.

In September, the ECB revised downwards its growth projections for the euro area to 1.4% in 2015, 1.7% in 2016 and 1.8% in 2017.

It should also be noted that the approval and start-up of the Third Bailout Programme for Greece has mitigated the risks in the area, a source of uncertainty for the Spanish and other European economies.

A characteristic of the current situation in the euro area is the trend towards disinflation. The ECB expects to end this year, 2015, with a positive – but very close to zero – inflation rate. The risk of deanchoring medium-term inflation expectations does not seem imminent, but even so, the tendency in recent months is once again somewhat worrying.

The phenomenon of inflation-free growth we are experiencing is one of the most noteworthy features of global economic developments in recent years, and a subject of debate and analysis by international economic organisations, academics and experts. The course of energy prices and globalisation are undoubtedly explanatory factors, but the phenomenon is admittedly one that poses many questions and, consequently, difficulties for economic policy.

ECB measures

For several years ECB monetary policy has striven to resolutely support economic recovery through standard and non-standard measures.

After exhausting the standard measures, in September 2014 the ECB announced its quantitative easing programme with two new components: the asset-backed securities (ABS) purchase programme and the covered bonds purchase programme. Subsequently, in January this year an agreement was reached to extend the programme to include public securities.

As at 30 September 2015, the assets acquired by the Eurosystem under the expanded purchase programme amounted to slightly more than €475 billion, a substantial amount of which (almost 72%) comprised government bonds.

The programme has helped enhance monetary policy transmission, by reducing the fragmentation of European financial markets, and provided for lower borrowing costs for households and firms. The depreciation of the euro has also contributed to easing financing conditions.

At its meeting on 3 September 2015, the Governing Council of the ECB expressed its readiness and ability, if required, to allow for more accommodation in its monetary policy stance. To this end, it could – if considered necessary – use the flexibility already embedded in the purchase programme to increase its size and extend its duration or modify its composition.

The Spanish economy

To conclude, I would like to briefly discuss the Spanish economy and its outlook.

During 2015 the Spanish economy has been in what we could call a “virtuous triangle”, by simultaneously meeting three conditions: robust inflation-free growth, job creation and an external surplus. In 2015 we are going to achieve GDP growth of more than 3%, a negative average annual inflation rate, a current account surplus of more than 1 pp of GDP, and growth in employment and social security registrations, prompting expectations of an unemployment rate of less than 20% of the labour force by end-2016. However, the degree of uncertainty in economic projections has widened notably in recent months and the risks of slippage have risen owing to the downturn in the outlook for global growth.

However, the Spanish economy is in a position to meet these challenges. The reforms implemented to date promote economic recovery and contribute to increasing Spain’s resilience in the face of exogenous shocks.

In any event, perseverance is necessary in correcting the imbalances that are a legacy of the crisis, in particular high unemployment and our sizeable international debit position. To this end, it is essential to maintain gains in competitiveness and contain indebtedness. Our rebalancing efforts were against an adverse backdrop, as a result of the severe recession affecting the Spanish economy between 2009 and the first half of 2013. We have not to overstate our economic policy leeway, or jeopardise fiscal consolidation, which should remain a guiding principle.

Thank you very much.