

Spain: From Recovery to Resilience

**Joint Conference Banco de España and International Monetary
Fund**

Madrid, April 3rd 2018

Dear Governor,

Dear First Deputy Managing Director,

- First of all, I would like to thank the Bank of Spain and the International Monetary Fund for having kindly invited me to close the joint conference on the economic outlook and challenges of Spain and the euro area.
- I am convinced that, given the seniority and expertise of the panelists, and the relevance of the topics that have been discussed, the conference has been fruitful and full of interesting insights.
- I will begin by giving you an overview of the outlook and challenges of the Spanish economy. Then I will turn to the importance of taking advantage of the current positive juncture to deepen the Economic and Monetary Union (or EMU). I will conclude by making some remarks on the key role Spain is willing to play in this regard.

Outlook and Challenges of the Spanish Economy

- Over the last three years the Spanish economy has been growing at rates above 3% - more than any other large advanced economy - and leading indicators point to a similar pace of expansion for the first quarter of 2018.
- So far, this trend has allowed the economy to recover its pre-crisis levels of GDP, its pre-crisis per-capita GDP, and 2/3 of the employment lost during the crisis.
- This dynamism has been favored by a structural change in our growth model, a shift that has several dimensions which I would briefly like to mention:
 - First, the Spanish economy has become more competitive. It has registered a current account surplus over the last five years, and international institutions expect this dynamic to continue in the years to come.
 - Moreover, there is evidence of a structural component in this surplus, as evidenced by the positive external balance despite rising energy prices, currency appreciation pressures and buoyant domestic demand.
- Indeed, this transformation of the external sector has resulted in a more balanced growth pattern. For the third consecutive year, both domestic and external demand are expected to continue adding to economic growth in 2018.

- Secondly, Spain is showing a strong capacity to create jobs. Employment continues to increase at a pace of around half a million jobs per year, and it is expected to reach roughly 19.5 million of employees by the end of 2018.
- It is worth mentioning that, since the peak reached in 2013, the unemployment rate has decreased by more than 10 percentage points. This is an unprecedented pace of unemployment rate reduction.
- As several international institutions have acknowledged, the GDP growth threshold beyond which the economy starts to create jobs has fallen. This is a clear sign of a fundamental change in the Spanish labor market dynamics.
- Thirdly, the functioning of the financial sector has substantially improved:
 - Growth of new loans to households and SMEs has been positive over the last three years; and
 - The average cost of debt of Spanish banks¹ is slightly below that of the other big euro area economies, which in turn enables financial institutions in Spain to provide loans at very competitive rates.
- One of the factors that have contributed to unlock credit to the real economy is the impressive deleverage process undertaken by the

¹ ECB Economic Bulletin N2/2018.

private sector since the peak of 2010 which, so far, accounts for a reduction of nearly 60 percentage points of GDP.

- Among the consequences of the more efficient allocation of credit, I would like to highlight the decline in the share of investment in construction in favor of other investment items that have a higher impact on productivity. Namely, investment in equipment and in intangible assets.
- In fact, since 2009 exports of goods and services have increased by more than 10 percentage points of GDP, while investment in construction has declined by roughly the same amount. This is a very representative picture of the structural transformation we are talking about.
- As a consequence, Spain has been able to combine rising hours worked per capita with productivity gains, which have been similar or even higher than those of our main peers.
- This important improvement would not have been possible without the fiscal consolidation that the Government has implemented. The fiscal deficit in 2017 stood at 3.1% of GDP, roughly 8 percentage points below that of 2009. The Government expects this deficit to fall well below 3% in 2018, thereby permitting Spain to leave the corrective arm of the excessive deficit procedure in the framework of the Stability and Growth Pact.
- Despite all these achievements, we cannot declare victory yet. There are still one million jobs to be created in order to recover the

pre-crisis level of employment, and the economy remains highly indebted.

- I believe, however, that we have set the basis for a sustained growth path over the next few years, a condition that is essential to keep reducing the public debt-to-GDP ratio, and to continue fighting against unemployment. Indeed, this is the socially most effective way to reduce inequality.
- I would like to remind you that a week ago the Government revised its growth forecast for 2018 upwards, from 2.3% to 2.7%. This expectation is prudent and is in line with both the national and international consensus forecast.
- If these projections are correct, the Spanish economy will have expanded more than the other big economies of the euro area for four years in a row.

Deepening the Economic and Monetary Union

- In my view, the positive juncture Spain and the euro area are currently experiencing should be understood as a great opportunity for deepening the EMU.
- This momentum won't last forever: sooner or later the euro area economy will be hit again by an adverse shock.
- One of the main lessons that can be drawn from the recent crisis is that the Eurozone is an incomplete monetary union that lacks

the required instruments to effectively absorb symmetric or asymmetric shocks.

- Although it is by now at an advanced stage, the banking union is still unfinished. And if we are to accomplish its goals in line with the roadmap agreed upon in 2016 by the Member States, we should focus on two main aspects that are pending:
 - Firstly, a common backstop for the Single Resolution Fund, that will certainly help in preserving financial stability in the Union as a whole.
 - Secondly, the third pillar of the banking union: a European Deposit Insurance Scheme, with its corresponding backstop. The so called EDIS will be crucial to:
 - Ensure that all deposits are equally safe, regardless of the country where they are located,
 - Put an end to the sovereign-bank diabolic loop, and
 - Adequately complement single supervisory and resolution mechanisms at a centralized level.

- As the Managing Director of the IMF recently stated in Berlin, it would be very important to set, at the European Council of June, a time horizon with specific dates in order to advance in the establishment of such scheme.

- Likewise, actions in the framework of the Capital Markets Union Action Plan should be accelerated in order to contribute to a smoother monetary policy transmission. It has a tendency to worsen in periods of bank distress.

- On top of a financial union, a common fiscal capacity should be put in place not only to absorb asymmetric shocks but also to ensure the appropriate policy mix can be achieved at the euro area level, thereby reducing the current over-reliance on monetary policy.
- In this sense I would like to welcome the work the IMF has been doing concerning the future of the EMU. A few days ago this institution published an excellent working paper, whose views are fully shared by the Government of Spain.
- As stated by the Managing Director of the IMF last week, this common fiscal capacity would not just contribute to prevent future crises but also to smooth the economic cycle and to improve the functioning of the EMU as a whole. At the same time it would force Member States to be responsible in terms of public finance, thereby preventing this mechanism from becoming a system of permanent transfers among countries.
- The stabilization role that would be assumed by this fiscal capacity in the IMF's proposal could be based on several pillars. I think the European Investment Bank could play a relevant role by providing the private sector with financing in times of financial stress, thus improving the dynamics of investment in Europe.
- Having said that, Spain has always considered that risk sharing and risk reduction should advance side by side.
- Over the last years, the euro area has adopted a new toolkit to ensure convergence and stability. These tools include the Single

Supervisory Mechanism, the Single Resolution Mechanism, the Macroeconomic Imbalances Procedure or the Fiscal Compact.

- Moreover, the negotiations on the Banking Package are at an advanced stage, and the work and proposals recently made by the ECB and the European Commission concerning high NPLs reduction represent important steps towards improving confidence on the European banking system. Clear progress can be observed on the risk reduction front.
- Spain has never been afraid of discussing these issues. On the financial front, significant steps have been taken so far. After an ambitious recapitalization, restructuring and balance sheet clean-up, the Spanish banking sector is now more efficient, competitive and profitable.
- The adoption of a sequence of measures that include an accurate asset valuation, adequate provisioning and the establishment of Sareb, an Asset Management Company, have been central to:
 - Reducing by 50% the stock of the NPLs (from the maximum reached in 2013), and
 - Bringing down the NPL ratio to a level similar to that of the EU and the euro area.
- Spain, like many other countries in Europe, had to face the worst financial crisis in decades. We confronted ours with responsibility, analyzing the problems, identifying the challenges of our economy, and putting in motion measures that, quite often, were neither simple nor easy.

- Therefore, as a country that has been able to overcome important adversities, we are in a good position to contribute to the decisive debate on the future of the euro area.

Conclusion

- Let me conclude;
- The economic growth pattern of Spain has undergone a structural change.
- The reforms implemented by the Government:
 - Have substantially contributed to this shift, setting the grounds for an extended recovery.
 - In addition, some of these reforms may actually be useful as a reference to face challenges that matter to Europe. A good example may be that of the Spanish experience with the reduction of NPLs.
- Now the aim is to proceed, as the name of this conference indicates, from recovery to building a resilient system that fosters a solid and sustainable economic expansion.
- Even if the momentum the euro area is experiencing calls for optimism, time is of the essence, and we should not be complacent.

- Deepening the EMU should be understood as a priority not only because the current economic and political situation promotes coordinated action on this front, but also because we have already created significant political expectations around this project.
- Let me say that Spain is ready to work in this regard and is willing to contribute to this essential debate.
- Thank you very much.