

## Letter from the Editors

We kick off the May issues of *Spanish Economic and Financial Outlook (SEFO)* by looking at the economic situation in the Eurozone. As we point out, the Eurozone recovery is taking root. The Commission's Spring 2017 forecasts put aggregate growth for the current year at 1.9% and 1.7% across the EU and Euro area, respectively – making this the fifth straight year of improvement. Unemployment continues to fall and inflation is accelerating. All of this together makes the question of ECB tapering one of when, not if. At the same time, Euro area economies are recovering at different speeds. In some countries, Italy, for example, growth remains below the European average and there are doubts surrounding the health of the financial sector, while in countries like Spain, restructuring and reforms, particularly in the banking sector, have been undertaken and the country is growing significantly above the EU average.

Policy makers need to take this EU heterogeneity into account to make sure the recovery brought about by extraordinary ECB measures is not stalled or reversed once these are discontinued.

In this context, the May SEFO examines more closely the situation across various segments of the Spanish economy as it consolidates its recovery. We note both definitive progress in some areas, as

well as the need to continue deepening reforms and correcting imbalances in others.

First, we analyse the characteristics of Spanish employment creation during the post-crisis period. Despite experiencing severe job destruction as a result of the crisis, from 2014-2016, Spain has recovered a little over one-third of the employment lost during the crisis years. Nonetheless, some of the undesirable aspects of the pre-crisis labour market remain in place – such as the high rate of temporary employment (although part-time employment has been reduced significantly), together with an important imbalance between the supply and demand for unskilled labour. These outstanding issues underline the need for further reforms, including of Spain's education model and the need to give greater emphasis to active labour market policies.

Next, we look at an interesting, and more novel, aspect of Spain's financial sector - digital proficiency. We present a customer snapshot of online banking in Spain by summarising the main conclusions of a recent study, which reveals that: 92% of banking customers regularly use the Internet, while 85.3% have smartphones, 44.3% have at least one computer at home and 47.2% own a tablet. Perceptions about digitalisation – namely related to

safety/security, control of expenditure, and user-friendliness – help to partially explain the role cash and some of the more traditional financial services continue to play as key financial services methods in Spain. As regards smartphones, these represent an important digital channel for financial transactions, but also a means of information exchange (communications and social networking tools). Overall, while it may be premature to say with certainty, there appears to be considerable upside in terms of digital financial penetration in Spain.

Related to the financial sector more broadly, we assess its recent performance on European stock markets and attempt to determine some of the key drivers underpinning improvement. After the dismal valuations reached in mid-2016, European – and notably Spanish – bank stocks recovered significantly in the second half of 2016 and into 2017, bringing the price-to-book value close to parity. The recent favourable performance seems to be driven less by fundamentals, but rather the following two factors: the pick-up in yield curves and expectations that regulatory pressure will ease.

We then move on to the Spanish real estate sector, where we find that, after a sharp adjustment during the crisis, house prices started to grow in 2015 and are now accelerating. On average, at the national and provincial level, the increase in prices is being matched by an improvement in household income, reflecting their payment capacity. However, the lack of up-to-date granular data makes it difficult to confirm whether this also applies at a more micro level. Future house price growth may be limited by subdued income growth and interest rate hikes, but

the sector's ability to generate noteworthy returns on investment should help support house prices going forward.

Finally, we dedicate the last section of this month's SEFO to an in-depth study of another sector which experienced important imbalances during the crisis – the external sector. Specifically, we examine the connection between Spanish non-price competitiveness and export performance in an EU context, the link between previous experience and survival of new export relationships in Spain, and the recent recovery of Spain's tourism sector, its relevance to GDP growth, and keys for future sustainability.

As regards competitiveness, empirical evidence suggests that internal non-price/cost factors dominate over strictly price/cost elements in determining the external competitiveness of the five largest EA economies. In the case of Spain, it appears to have recovered by the end of 2015 virtually all the cost-competitiveness lost between 2000 and 2008. Nonetheless, building on our earlier observation, internal devaluation policies are likely to have only a limited impact on restoring competitiveness compared to those aimed at strengthening capitalization and providing the right incentives for exporters.

On a related note, an empirical analysis of Spanish exporters' survival rates shows that, while early-stage survival is difficult, new trade relationships make a significant contribution to aggregate export growth over time. In any event, the large degree of heterogeneity across successful export relationships in Spain should be a key consideration at the time of designing export promotion policies.

Finally, on the topic of tourism, tourist arrivals into Spain exceeded 75 million in 2016, placing Spain in third position in the global ranking of tourist destinations, behind France and the United States. This is an exceptional outturn, consolidating the country's position against its immediate rivals. Tourism inflows have enabled the tourism sector to increase its weight in the Spanish economy, becoming a key element of the recovery since 2014 and regaining an impetus that had appeared to be dissipating. Pursuing goals to attract the optimal type of tourism will help to ensure the sector's profitability and sustainability into the future.