

## **ANNUAL REPORT 2021**

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## Chapter 1

An incomplete recovery amid uncertainty: from the pandemic to the rise in inflation and the outbreak of war

## Chapter 2

Challenges and policies for sustainable and balanced growth of the Spanish economy

## Chapter 3

Rising global inflation

## Chapter 4

The Spanish economy and the climate challenge

## CONTENTS

1. Introduction
2. A broad range of structural challenges and policies to address them
3. The fiscal consolidation challenge
4. The role of European policies

## OVERVIEW

- The outlook for the Spanish economy over the medium and long term will be shaped by a set of huge structural challenges
- The Spanish economy's ability to follow a robust, sustainable and inclusive growth path in the years ahead will hinge on the economic policy response to this set of challenges
- The scale of these challenges and their close interrelatedness call for a comprehensive strategy of lasting and ambitious structural reforms

## A BROAD RANGE OF STRUCTURAL CHALLENGES...

Job creation  
and  
employment  
stability

Sustainability of  
public finances

Training and  
human capital

Productivity

Digitalisation

NGEU  
programme

Climate change

Globalisation  
dynamics

Inequality

Firm size

European  
institutional  
framework

Population  
ageing

Cross-sectoral  
reallocation

Challenges  
facing the  
banking sector

Innovation and  
technological  
capital

# ... AND POLICIES TO ADDRESS THEM



## SOME OF THESE CHALLENGES ARE ANALYSED IN DETAIL IN THIS CHAPTER, IN THE LIGHT OF THE LATEST DATA, ANALYTICAL WORK AND PUBLIC POLICY DEVELOPMENTS

The challenge of boosting job creation and strengthening employment stability

The challenge of training and increasing human capital

The challenge of addressing inequality

The challenge of increasing firm size, facilitating cross-sector reallocation and fostering innovation

The challenge of fully capitalising on the roll-out of the Next Generation EU (NGEU) programme

The challenge of fiscal consolidation

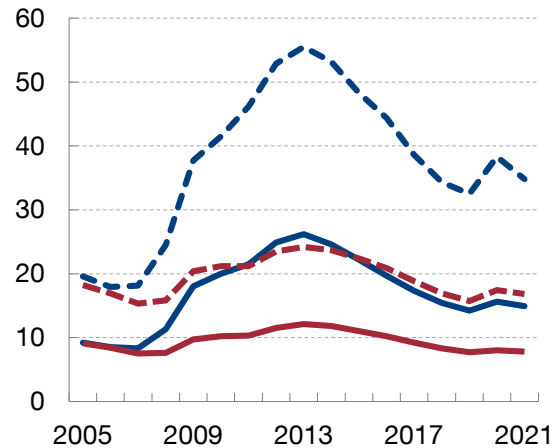
The challenges of European policies

# THE CHALLENGE OF BOOSTING JOB CREATION AND STRENGTHENING EMPLOYMENT STABILITY

- In recent decades, Spain's unemployment rate and temporary employment ratio have persistently been significantly higher than the average of the euro area economies
- This has particularly affected young people, whose part-time employment rate has also grown since the global financial crisis

### UNEMPLOYMENT RATE

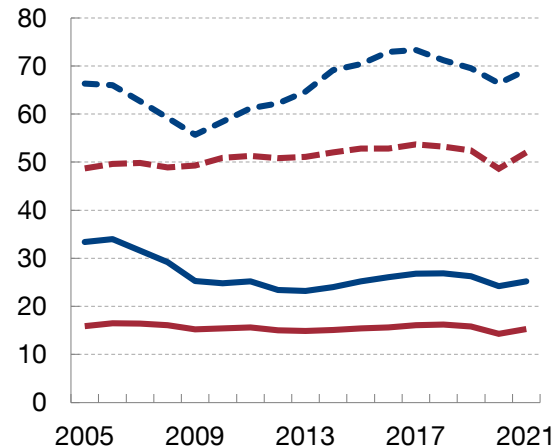
% of labour force



— SPAIN, AGES 15-64  
 - - SPAIN, AGES 15-24  
 — EURO AREA, AGES 15-64  
 - - EURO AREA, AGES 15-24

### TEMPORARY EMPLOYMENT RATIO

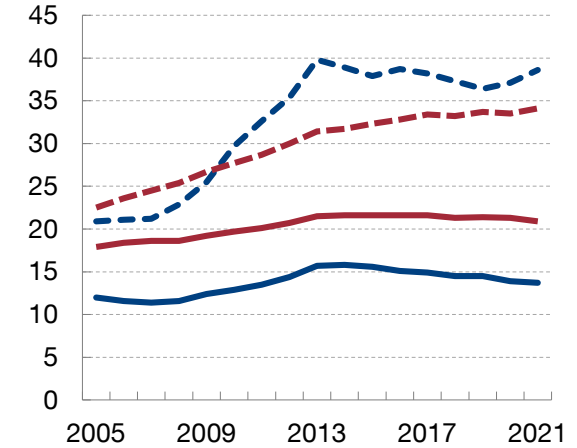
% of wage-earners



— SPAIN, AGES 15-64  
 - - SPAIN, AGES 15-24  
 — EURO AREA, AGES 15-64  
 - - EURO AREA, AGES 15-24

### PART-TIME EMPLOYMENT RATE

% of wage-earners



— SPAIN, AGES 15-64  
 - - SPAIN, AGES 15-24  
 — EURO AREA, AGES 15-64  
 - - EURO AREA, AGES 15-24

SOURCE: Eurostat (Labour Force Survey).

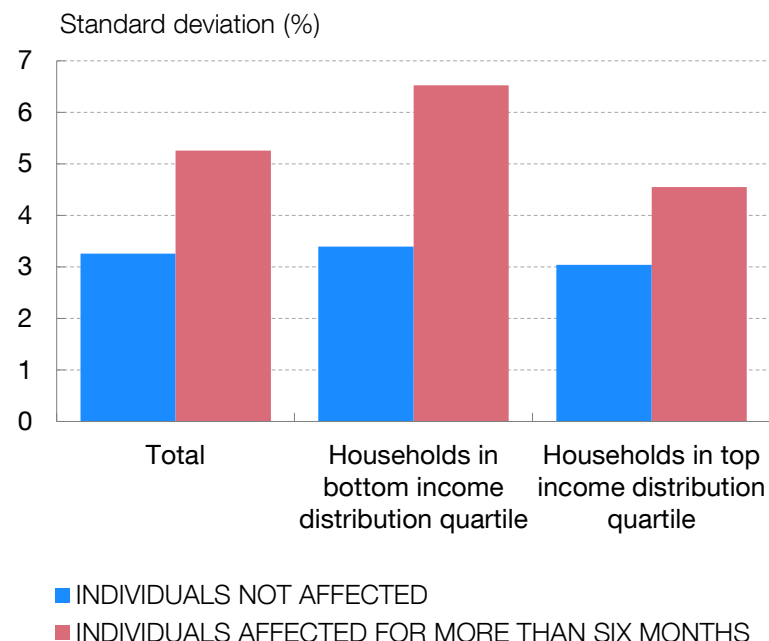
# HIGH EMPLOYMENT INSTABILITY HAS ADVERSE ECONOMIC EFFECTS IN MANY SPHERES

- For example, employment instability affects the accumulation of workers' human capital and can thus have very persistent effects on their working lives
- It also affects the degree of uncertainty about future income, with direct consequences for spending decisions, emotional well-being, the formation of new households and the birth rate

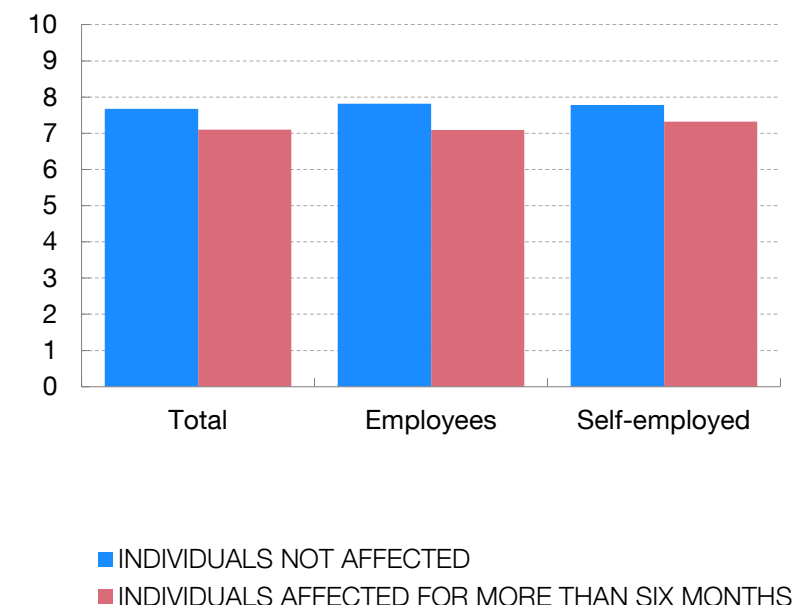
**WAGE RETURNS TO EXPERIENCE BY TYPE OF CONTRACT AND SKILL LEVEL**



**UNCERTAINTY ABOUT FUTURE INCOME**



**AVERAGE SATISFACTION: TOTAL AND BY EMPLOYMENT STATUS IN 2019 (a)**



SOURCES: Continuous Sample of Working Histories and EFF (2020).

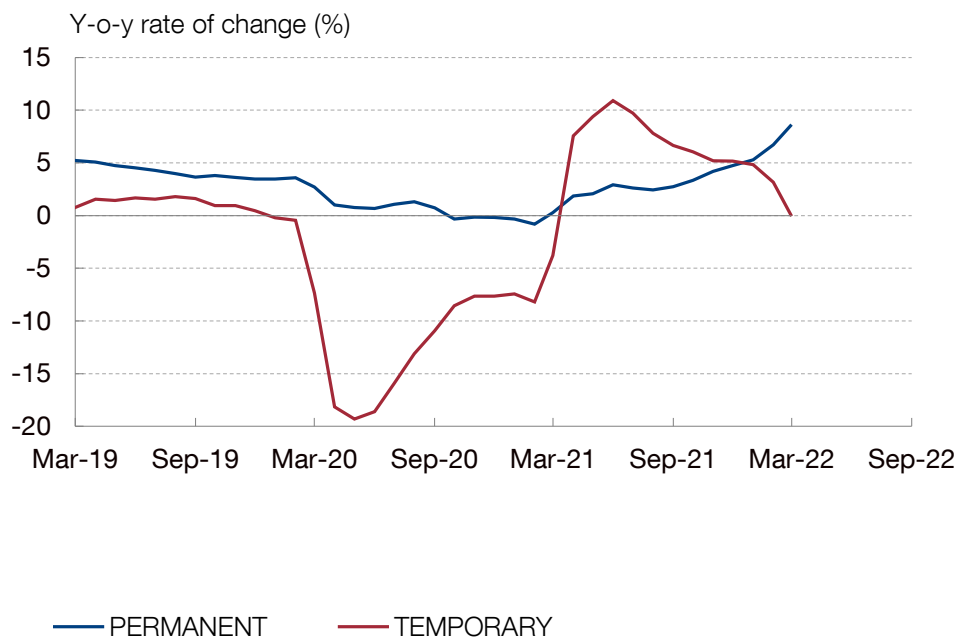
a Average satisfaction is measured drawing on a question in the Spanish Survey of Household Finances (EFF) on "the level of life satisfaction of the respondent, considering all aspects jointly". A value of 10 would indicate "fully satisfied" and a value of 0 would indicate "not satisfied at all". The chart depicts the average value for each group.



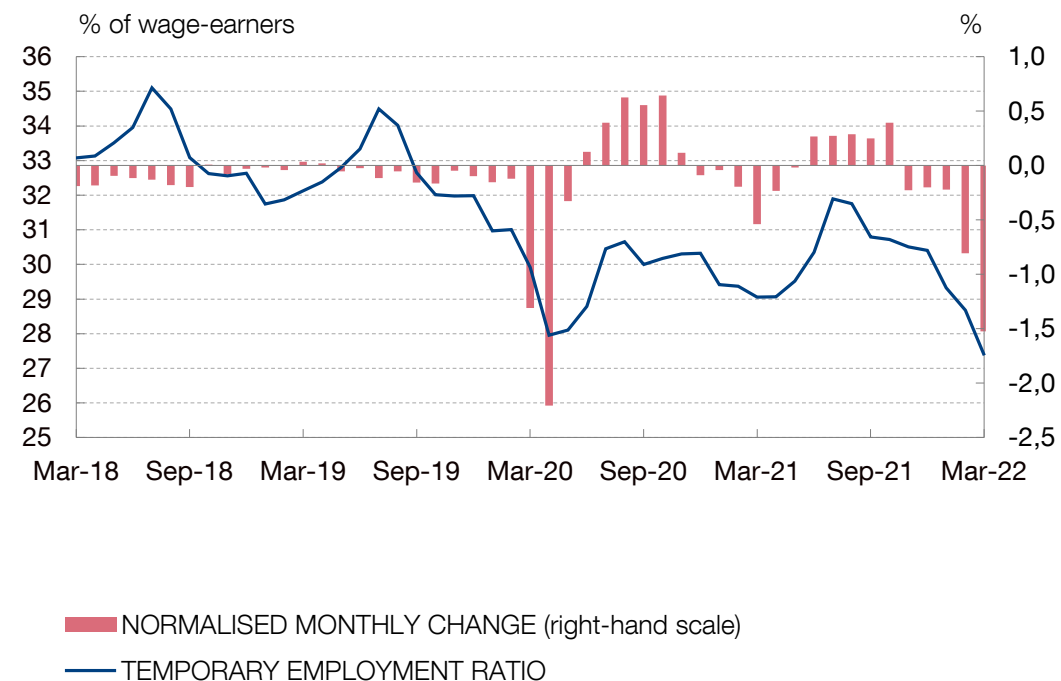
# ONE OF THE MAIN OBJECTIVES OF THE LABOUR MARKET REFORM ENACTED IN 2022 IS TO COMBAT THE HIGH PROPORTION OF TEMPORARY EMPLOYMENT

- In recent months, permanent hiring has quickened significantly, and temporary hires have decreased
- It is, however, early to assess the impact of the labour market reform, and any such evaluation will have to consider numerous issues (its impact on employment, labour turnover, working lives, the quality of the jobs created, business productivity, ...)

**SOCIAL SECURITY REGISTRATIONS BY TYPE OF CONTRACT**



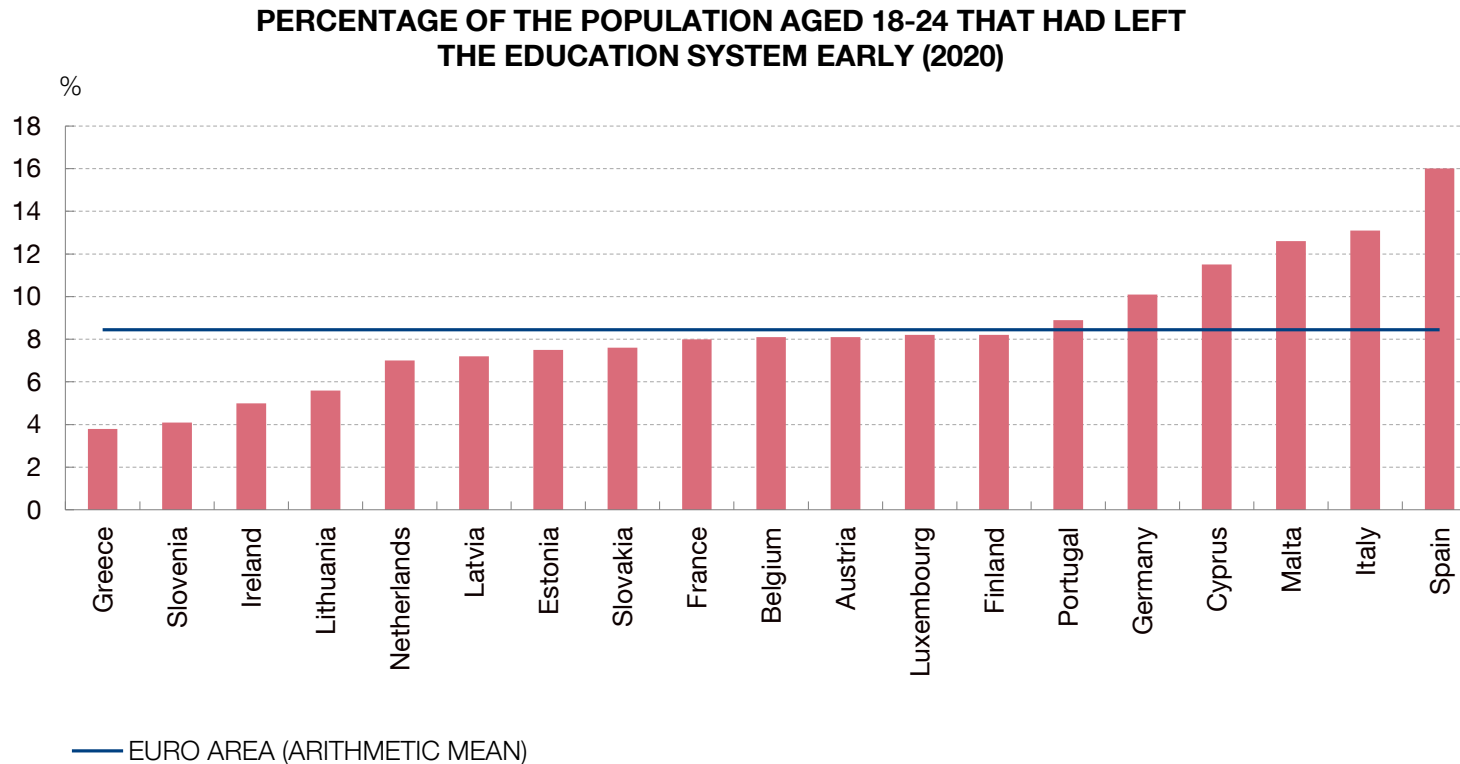
**TEMPORARY EMPLOYMENT RATIO**



SOURCES: Banco de España and Ministerio de Inclusión, Seguridad Social y Migraciones.

# THE CHALLENGE OF TRAINING AND INCREASING HUMAN CAPITAL

- Increasing the educational attainment level of workers and employers is crucial to reducing structural unemployment, boosting productivity and fostering the creation of higher quality jobs
- In recent decades, the Spanish population's level of educational attainment has improved considerably; however, Spain is still behind its European peers in this respect (by way of illustration, in 2020 Spain had the highest early school leavers' rate in the European Union)

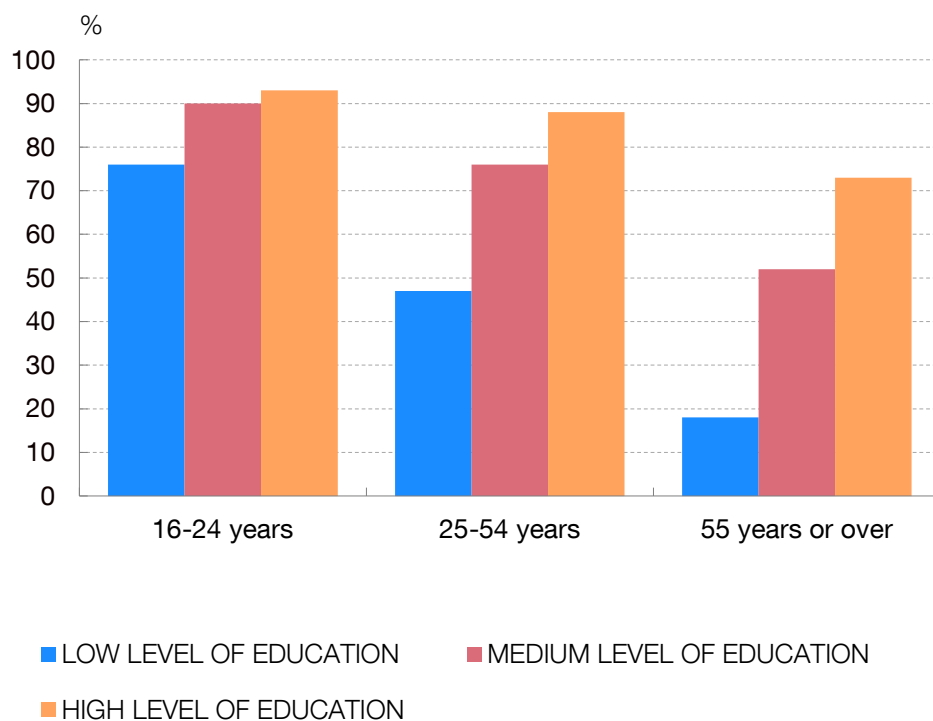


SOURCE: Eurostat (Labour Force Survey).

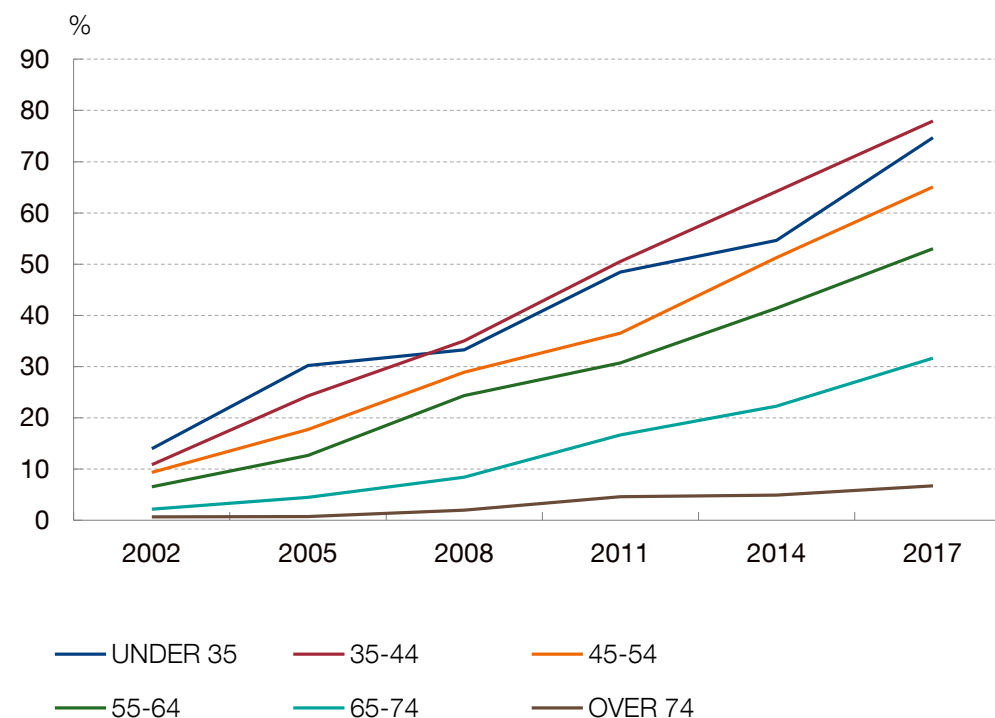
# TACKLING THIS CHALLENGE IS ESPECIALLY IMPORTANT IN THE CURRENT SETTING (DIGITALISATION, POPULATION AGEING, REALLOCATION, ...) AND REQUIRES ACTION ON NUMEROUS FRONTS (I)

- Harnessing the opportunities of digitalisation calls for increasing the population's digital skills, especially in the case of the older generation, those with lower educational attainment levels and those on lower incomes

**PERCENTAGE OF INDIVIDUALS WITH BASIC OR ABOVE BASIC DIGITAL SKILLS BY CHARACTERISTICS**



**USE OF ONLINE BANKING BY AGE**

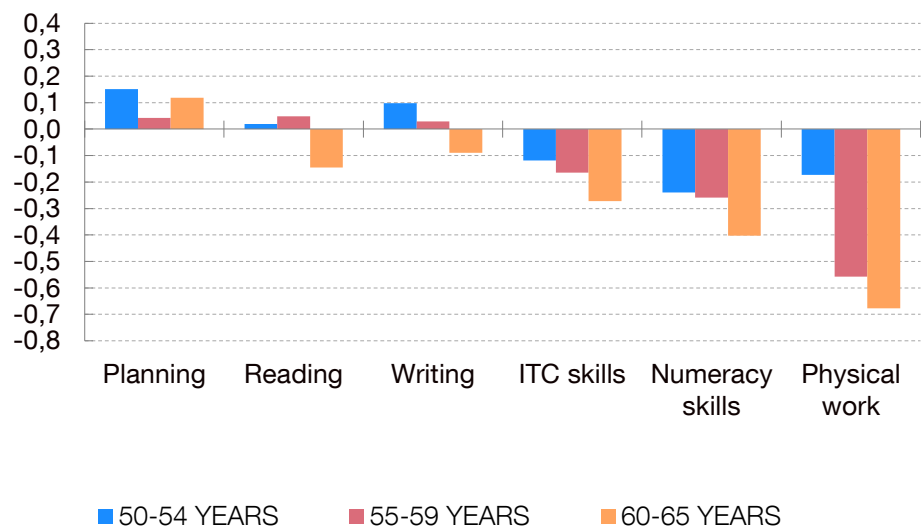


SOURCE: Banco de España (EFF).

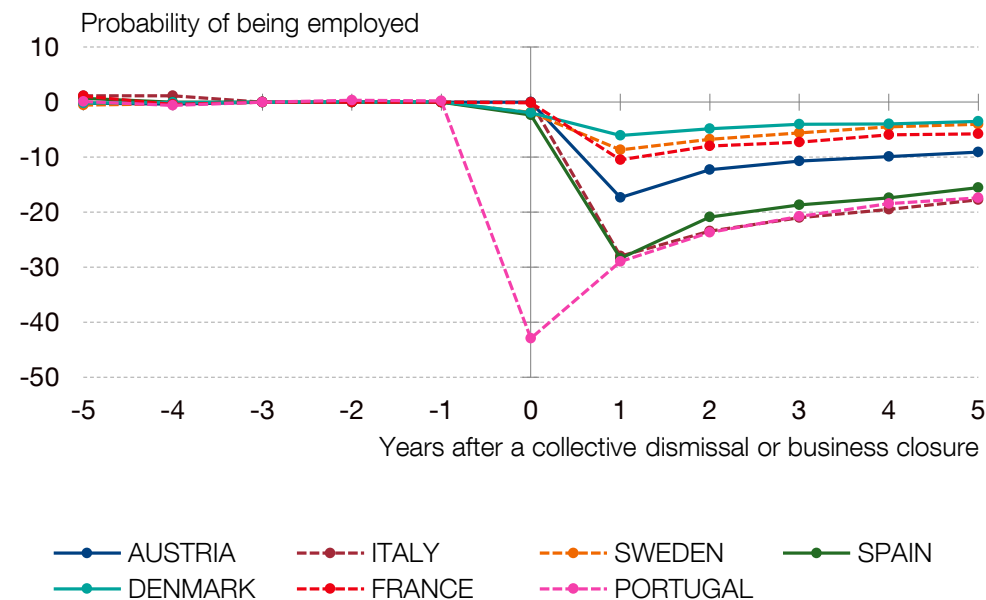
# TACKLING THIS CHALLENGE IS ESPECIALLY IMPORTANT IN THE CURRENT SETTING (DIGITALISATION, POPULATION AGEING, REALLOCATION, ...) AND REQUIRES ACTION ON NUMEROUS FRONTS (II)

- A comprehensive skill recycling strategy throughout the life cycle is key in a setting in which society finds itself faced with marked population ageing and, at the same time, the need to extend people's working lives
- Active labour market policies are also vital for limiting the loss of human capital stemming from job losses

**CHANGE IN THE SKILL INDICATOR COMPARED WITH 30-34 AGE GROUP (a)**



**EFFECT OF JOB DISPLACEMENT ON THE CHANGE IN THE PROBABILITY OF BEING EMPLOYED IN SEVERAL EU COUNTRIES (b)**



SOURCES: Eurostat, OECD (PIAAC) (2013), AMDB administrative social security data in Austria (1984-2019), IDA database in Denmark (1980-2018), DADS database in France (1991-2018), INPS social security records in Italy (1998-2005), QP database in Portugal (1987-2018), Continuous Sample of Working Histories in Spain (2005-2019), RAMS tax authorities database in Sweden and LOUISE database in Sweden (1994-2016).

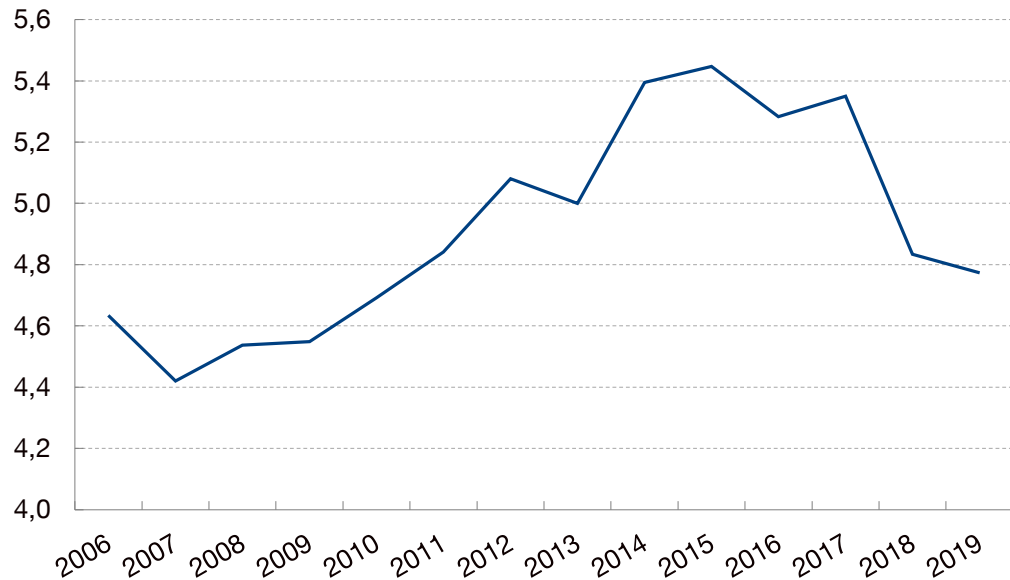
a The bars denote the estimated coefficients for indicators for each age group (50-54, 55-59 and 60-65) in a regression that includes sex, education level and dummy variables for the sector of activity, for occupation and for each age group. The dependent variable is the skill use at work indicator.

b Change in the probability of being employed relative to the average probability of being employed in the five years prior to the collective dismissal.

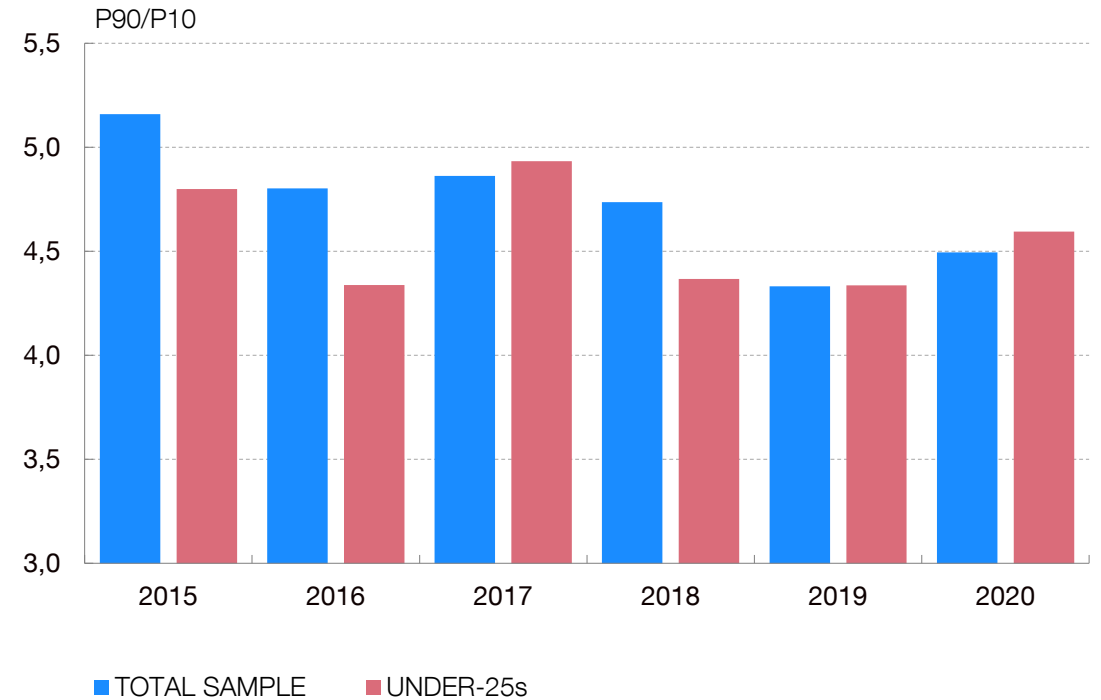
# THE CHALLENGE OF ADDRESSING INEQUALITY

- Levels of inequality in the Spanish economy were already high before the outbreak of the pandemic and, despite the key mitigating role played by public policy, they are likely to have increased as a result of the health crisis

**CHANGES IN THE P90/P10 RATIO OF HOUSEHOLD NET INCOME PER CAPITA (a)**



**MONTHLY WAGE INEQUALITY**



SOURCE: INE (ECV and EPA).

a. Household net income per capita is household net income adjusted using the OECD equivalence scale.

## TO MITIGATE THE ADVERSE EFFECTS OF INEQUALITY, PUBLIC POLICY MEASURES MUST BE ROLLED OUT AND CONTINUOUSLY ASSESSED ACROSS A WIDE RANGE OF AREAS

- Examples include labour market regulation and education policy, and also incomes and housing policies

Improving the educational attainment levels of the most disadvantaged groups is a highly effective means of boosting their income, levelling up job opportunities ex ante and enhancing the prospects of future generations

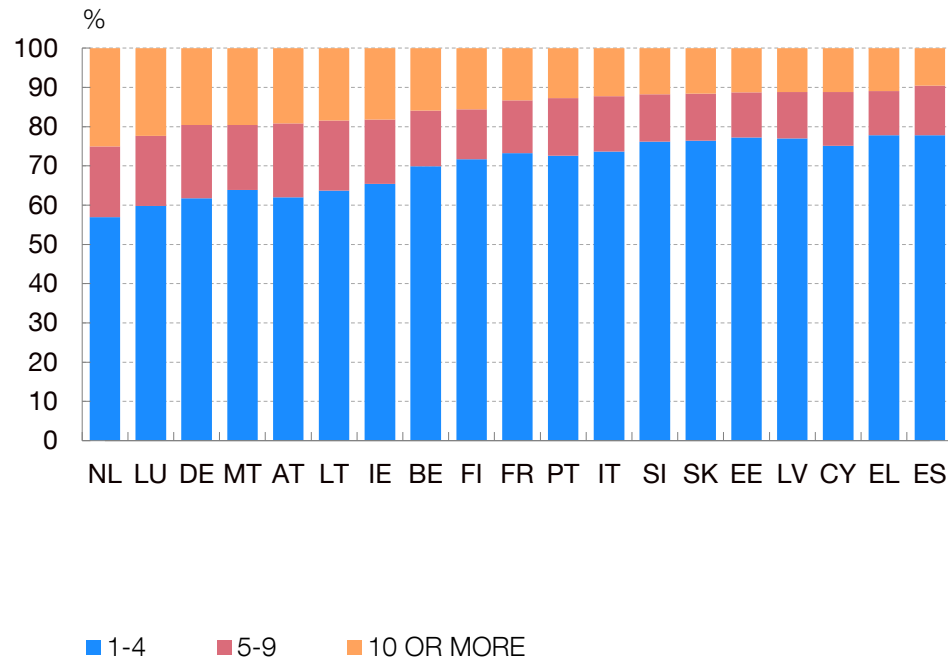
As far as incomes policies are concerned, according to the findings of the assessments required by law, further adjustments must be made to the conditions governing eligibility for Spain's minimum income scheme, to ensure that this instrument can effectively fulfil its mission of eradicating extreme poverty while avoiding undesired effects

The draft Law on the right to housing seeks to ease difficulties in accessing housing. However, some of the measures envisaged, such as rent control, may not have the desired effect or may even have potentially significant adverse effects in the medium term. Conversely, some measures geared to offering greater effective legal certainty to landlords are absent

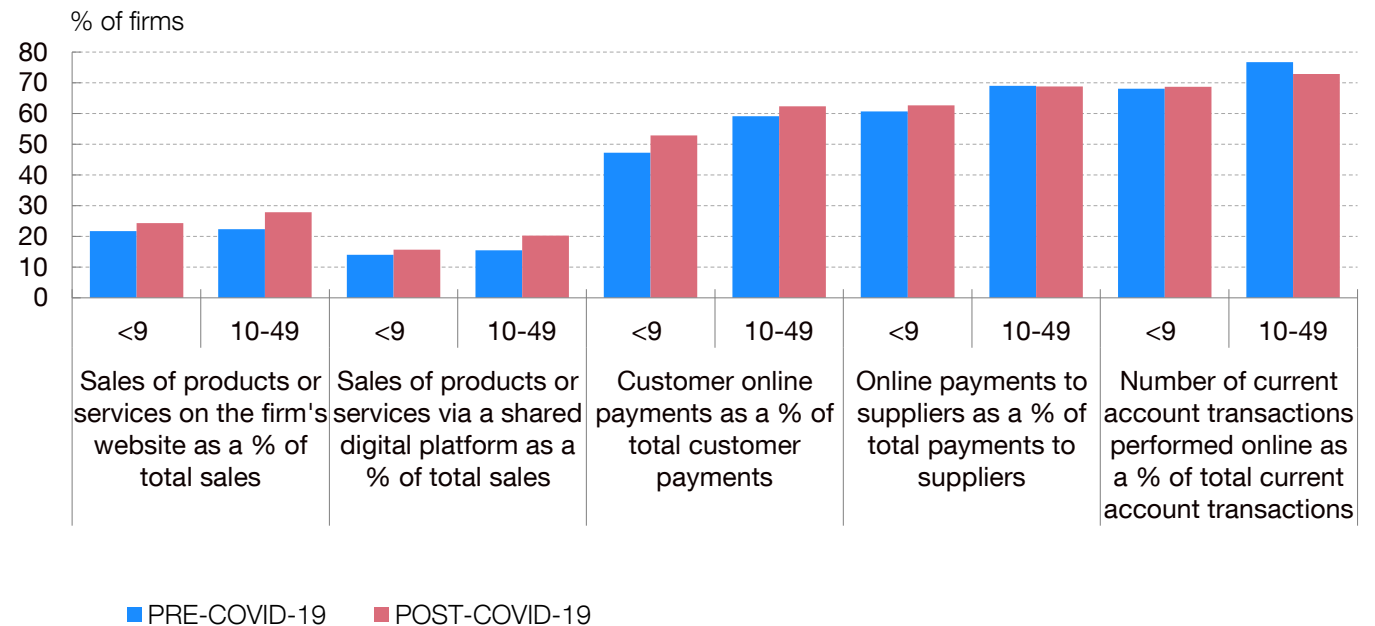
# THE CHALLENGE OF INCREASING FIRM SIZE, FACILITATING CROSS-SECTOR REALLOCATION AND FOSTERING INNOVATION

- The small size of Spanish firms is one of the factors that explains Spain's low aggregate productivity
- To illustrate this point, data from the Banco de España's Survey of Small Enterprises' Financial Literacy show that small Spanish firms are not generally benefiting from the changes in marketing processes brought about by digitalisation

**PERCENTAGE OF BUSINESSES BY EMPLOYEE NUMBER FOR EURO AREA COUNTRIES**



**SOME DIGITAL TRANSACTIONS BY FIRM SIZE**



SOURCES: Banco de España (2021 Survey of Small Enterprises' Financial Literacy) and Eurostat (Structural Business Statistics).

# IT IS ESSENTIAL TO EXPLORE THE REASONS WHY THE SPANISH BUSINESS SECTOR IS SO SKEWED TOWARDS SMALL, LOW-PRODUCTIVITY FIRMS AND TO MITIGATE THEIR EFFECTS...

- These reasons notably include:

The volume and quality of regulation

Mechanisms that influence the creation, growth and winding-up of businesses

SMEs' limited access to a wider range of external financing sources on more favourable conditions

Business innovation support policies

The regulation of economic activity in Spain has increased in complexity in recent decades, with a potentially adverse impact on business dynamics and aggregate productivity

The draft Law on business start-ups and growth, the draft Law on developing the ecosystem of emerging businesses and the reform of the Insolvency Law are a step forward whose effectiveness will have to be assessed over the coming quarters

Small businesses need help to access venture capital firms, which tend to specialise in funding newly created businesses and innovative activities

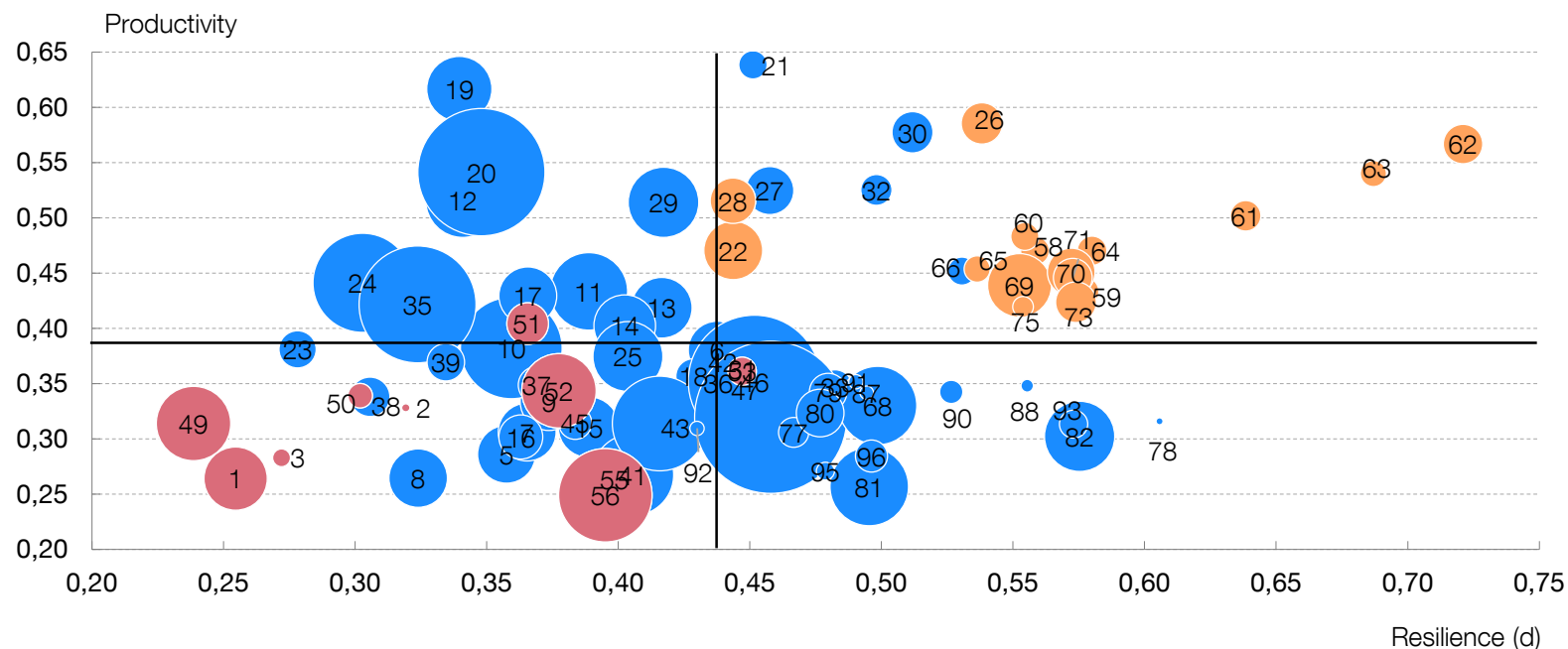
Greater synergies are needed between the different public and private institutions that pursue innovation, and the tax incentives and direct subsidies for R&D&I projects in Spain must be reviewed and rigorously designed



# ... WHICH WOULD ALSO FACILITATE THE REALLOCATION OF ACTIVITY ACROSS SECTORS AND FIRMS THAT THE SPANISH ECONOMY MUST ADDRESS GOING FORWARD

- A recent Banco de España paper finds that, given the widely differing positions of Spain's firms and industries in the face of the structural changes that will shape the course of the economy in the more immediate future, a far-reaching process of reallocating activity across sectors and firms will be required if the opportunities deriving from such challenges are to be harnessed

**POSITIONING OF SPANISH INDUSTRIES VIS-À-VIS THE MAIN ECONOMIC CHALLENGES.  
INTERNAL CENTRALITY (a)**



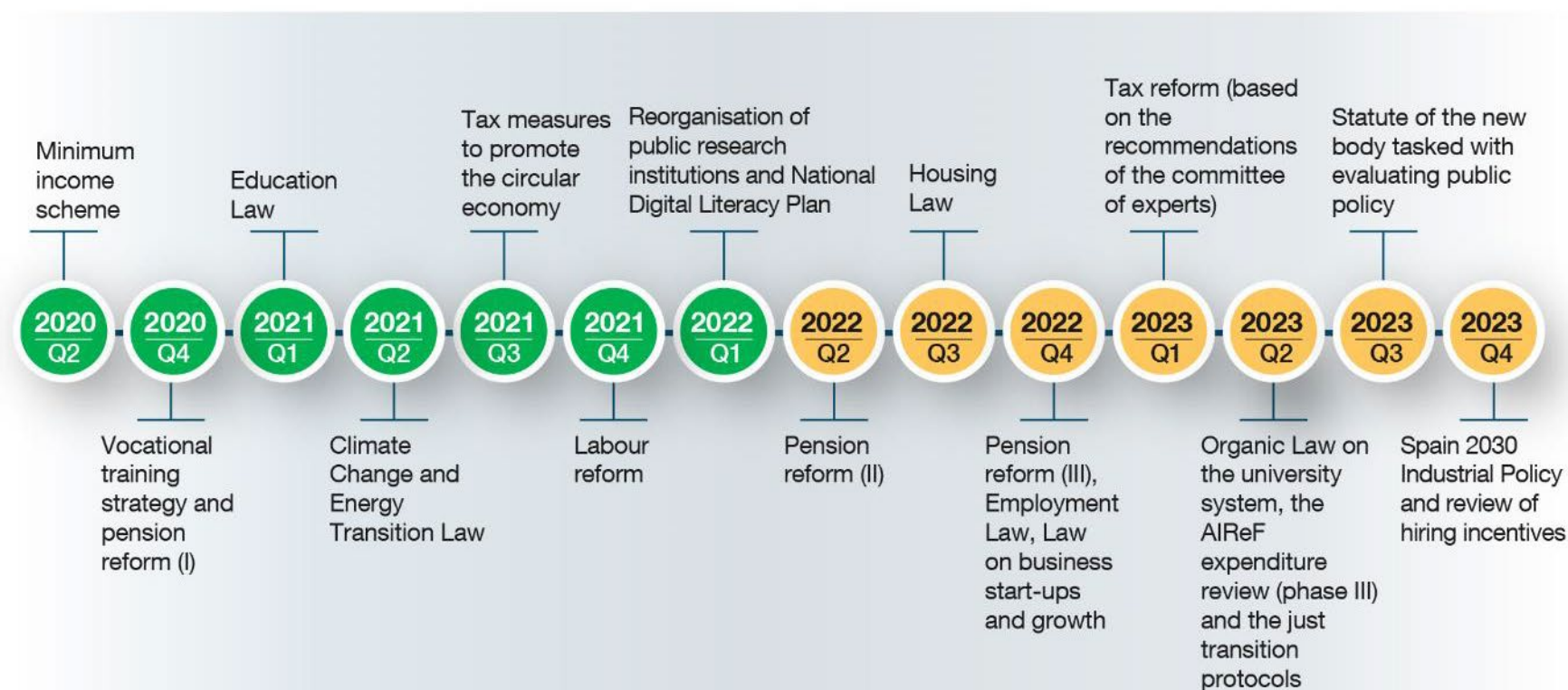
SOURCE: Banco de España.

a The size of the bubbles denotes the degree of internal centrality, which reflects the importance of each sector as a customer and supplier in the production chain, as well as its relative weight in the overall economy in terms of employment, number of companies and exports, inter alia. Resilience groups a number of sectoral indicators for withstanding technological and digital transformation, the energy transition and population ageing (see Fernández-Cerezo and Montero (2021)).

# THE CHALLENGE OF FULLY CAPITALISING ON THE ROLL-OUT OF THE NGEU PROGRAMME

- The rigorous selection of the investment projects to be funded under the NGEU programme is one of the factors that may most influence its success in Spain
- Another is the fact of it being accompanied by an ambitious programme of structural reforms

## MAIN ACTIONS PROPOSED IN THE SPANISH RECOVERY, TRANSFORMATION AND RESILIENCE PLAN (a)

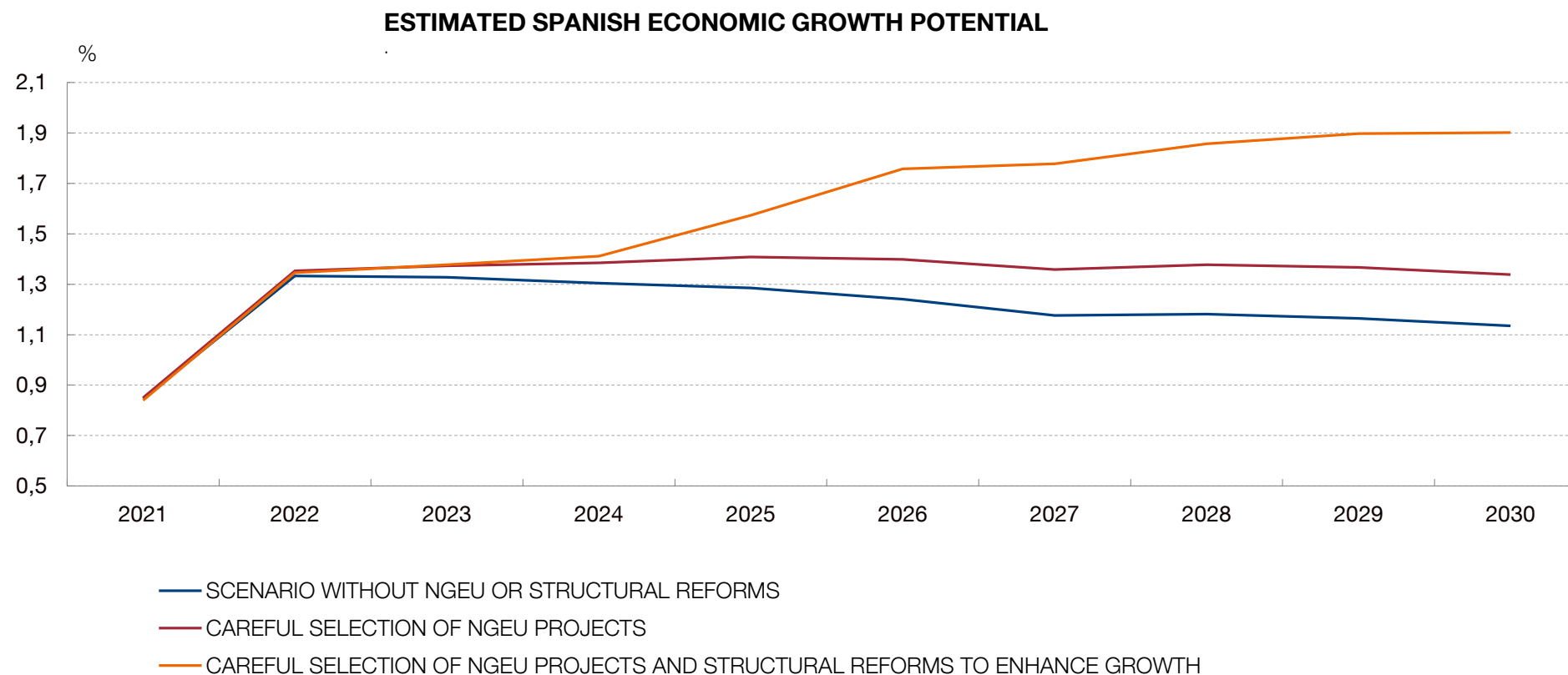


**SOURCE:** Banco de España, drawing on the Recovery and Resilience Facility Operational arrangements between the European Commission and Spain.

a Reforms already completed are in green, while pending reforms are in yellow.

# A RECENT BANCO DE ESPAÑA PAPER ILLUSTRATES THE IMPORTANCE OF A RIGOROUS SELECTION OF THE NGEU PROJECTS AND OF THE IMPLEMENTATION OF AMBITIOUS REFORMS

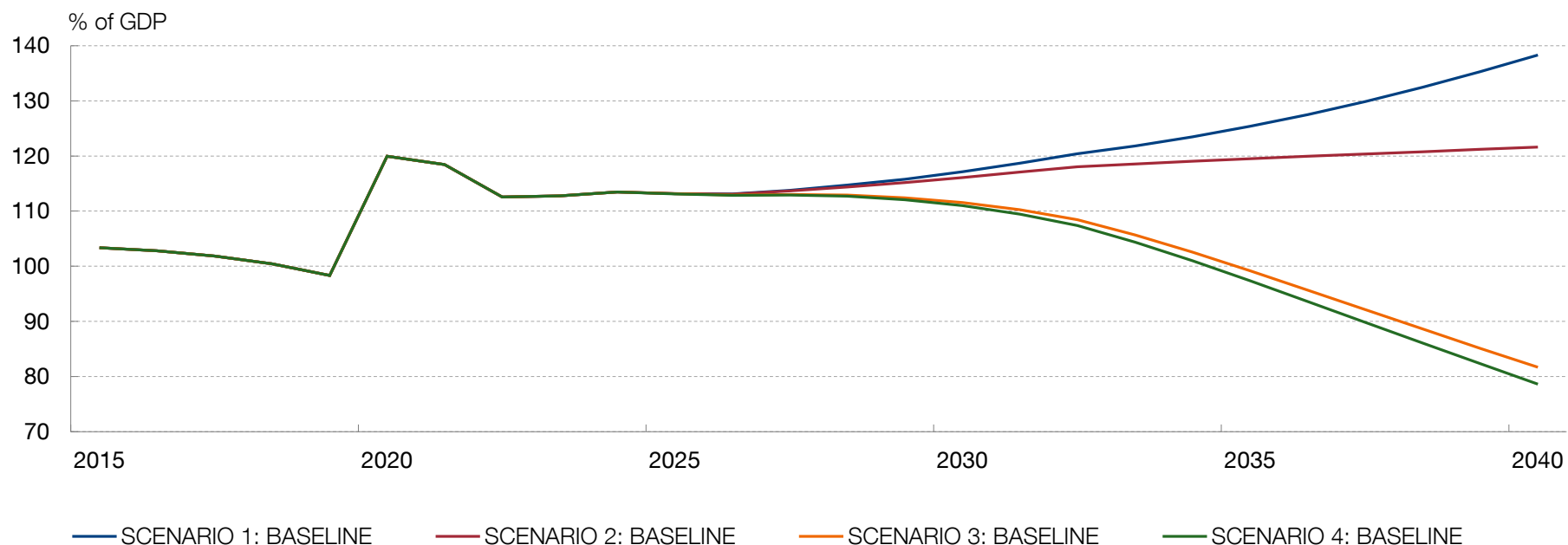
- Different combinations of reforms and investment projects associated with the NGEU programme could have a very different impact on the Spanish economy's medium-term growth capacity



SOURCE: Banco de España.

- To bolster the sustainability of Spanish public finances, a multi-annual fiscal consolidation plan will have to be rigorously implemented, once the pandemic is over and the adverse economic effects of the war in Ukraine have diminished

**SIMULATED PUBLIC DEBT PATHS UNDER VARIOUS SCENARIOS (a)**



SOURCE: Banco de España, on INE and IGAE data.

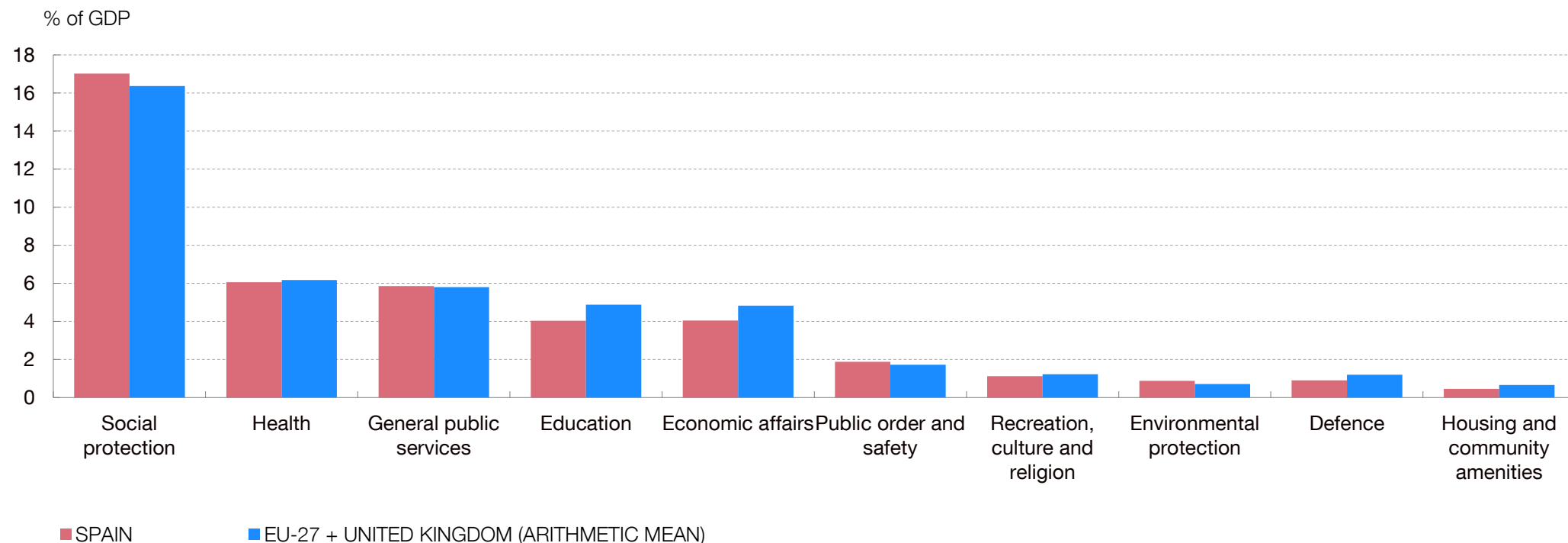
a Drawing on “Macroeconomic projections for the Spanish economy (2022-2024)”, Box 1 of the “Quarterly report on the Spanish economy”, *Economic Bulletin* 1/2022, Banco de España.

All the scenarios include a deterioration in the structural primary balance up to 2040 owing to ageing costs (pensions, health care and long-term care). Scenario 1 assumes a fiscal policy that does not correct that deterioration. Scenario 2 envisages a fiscal policy that makes a consolidation effort consistent with maintaining the structural primary balance envisaged in the Banco de España’s latest projections for 2024. Alternatively, scenario 3 assumes a fiscal policy that makes a further adjustment to the structural primary balance of 0.3 pp of potential GDP each year, until structural balance equilibrium is reached. Lastly, scenario 4 modifies scenario 3 with long-term potential GDP growth of 1.9% (instead of 1.3% as assumed in all the other scenarios).

# GENERAL GOVERNMENT EXPENDITURE MUST BE SUBJECT TO EXHAUSTIVE REVIEW, TO INCREASE EXPENDITURE EFFICIENCY AND PROMOTE MORE ROBUST AND EQUITABLE ECONOMIC GROWTH

- Education and public investment expenditure, two budget items that are essential to drive economic growth and reduce inequality, account for a lower share of Spain's general government accounts than they do in the European Union overall

GENERAL GOVERNMENT FUNCTIONAL EXPENDITURE (AVERAGE 2015-2019) (a)



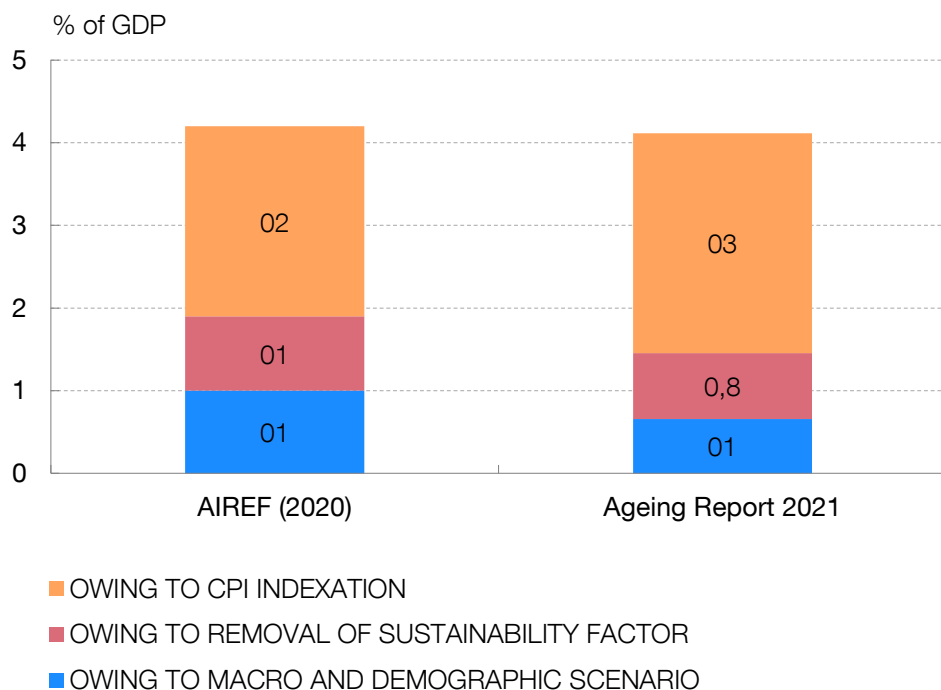
SOURCE: Eurostat.

a The functional classification catalogues public expenditure by the purpose for which it is to be used.

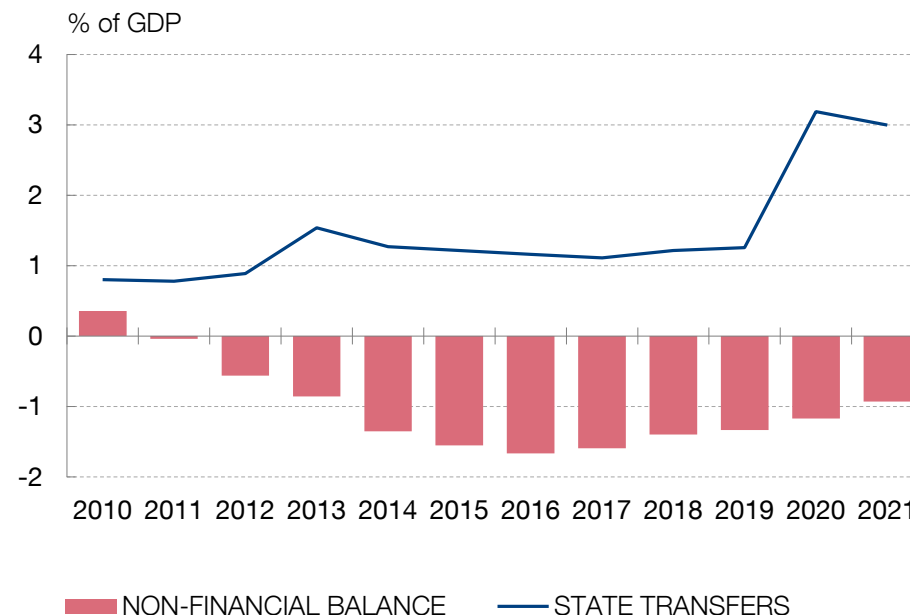
# IN RECENT MONTHS VARIOUS MEASURES AFFECTING THE PENSION SYSTEM HAVE BEEN APPROVED, BUT MORE WILL BE NEEDED IN FUTURE

- On the estimates available, which include the latest measures adopted (among others, the removal of the sustainability factor and the introduction of an intergenerational equity mechanism), fresh future actions will be needed on either the revenue or the expenditure side, or on both sides, to cater for the growth in pension expenditure stemming from population ageing

**PROJECTED INCREASE IN PENSION EXPENDITURE, 2019-2050**



**SOCIAL SECURITY BALANCE AND STATE TRANSFERS TO SOCIAL SECURITY**

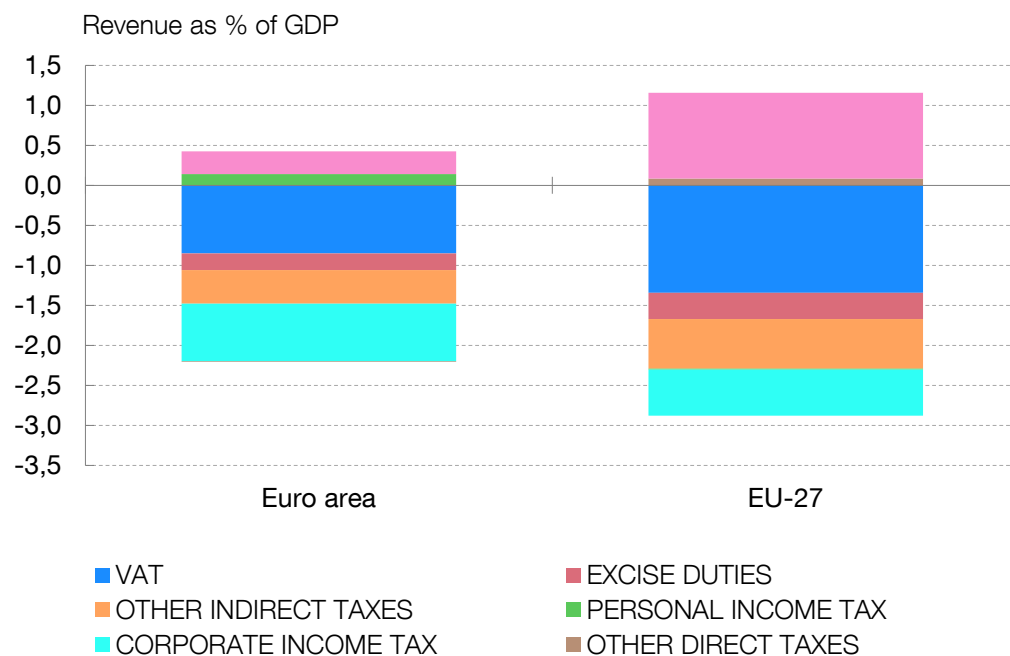


SOURCE: Banco de España.

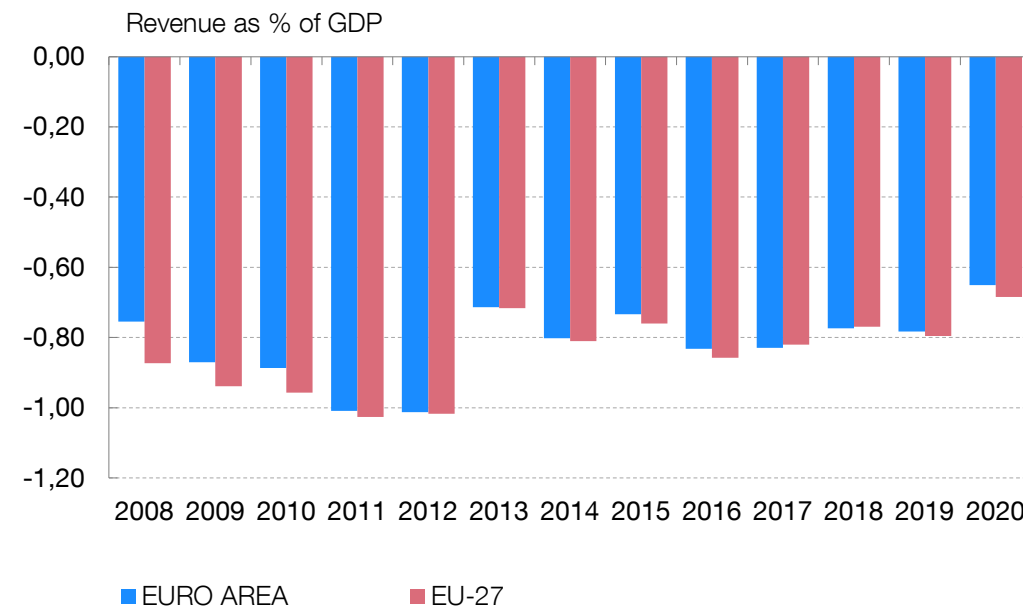
# A COMPREHENSIVE REVIEW OF THE TAX SYSTEM IS NEEDED TO ASSESS WHETHER THE DIFFERENT TAXES MEET THEIR GOALS IN THE MOST EFFECTIVE AND EFFICIENT MANNER POSSIBLE

- Shifting the burden of taxation from income to consumption yields potential efficiency and equity gains
- The ambitious environmental goals assumed by Spain point to the need to introduce new tax measures in energy, hydrocarbons and transport
- The growing digitalisation and globalisation of economic activity require greater international coordination and harmonisation of the tax system

**REVENUE GAP BY TAX, 2015-2020**



**REVENUE GAP GREEN TAXATION**



SOURCE: Eurostat (2022).

# THE CHALLENGE OF EUROPEAN POLICIES

- The growing importance of European policies – as an essential factor in Member States’ economic activity and to address shocks that affect the EU economies overall – mean that it is now more important than ever to continue making firm progress to strengthen the European institutional framework

