

## Consumption and engines of growth

The Dossier in this *Monthly Report* focuses on household consumption, the Spanish economy's main component of gross domestic product (GDP) on the demand side. It accounts for 57% of GDP, a figure that excludes goods supplied by public administrations such as education, health, security and defence (which would account for a further 20% of GDP). It could even be argued that household consumption is a better gauge of well-being than GDP per se. Ultimately, our satisfaction comes from consuming rather than producing.

Some may be surprised to hear that household consumption in Spain, in real terms, is 5% lower than its pre-crisis peak in spite of its recovery over the past few years. Although GDP returned to its pre-crisis level by the second quarter of this year, consumption has yet to catch up. This is because exports have essentially driven the recovery of the Spanish economy.

In fact, cause and effect are often being confused when consumption is deemed to be the engine of economic growth. Consumption certainly helps to explain an economy's cyclical movements. When confidence wanes or uncertainty escalates, consumers tend to postpone decisions to purchase durable goods or spend less on leisure, for example. And as consumption accounts for a very large share of GDP, even small fluctuations in the propensity to consume have a considerable impact on GDP as a whole.

But an economy's long-term growth and its capacity to consume are actually determined by savings and investment. And both help to improve productivity; i.e. producing more with less. Savings finance investment in both physical and human capital. Excessive consumption, or rather insufficient savings, therefore end up having a negative effect on an economy's growth potential. Several factors can boost productivity. One is innovation, such as the development of new products, business models or better production processes. Significant benefits can also be obtained from agglomeration economies, such as clusters, as well as the appropriate allocation of resources according to changes in the environment. Good quality education, a flexible production system that is open to competition, a regulatory environment that encourages the creation and growth of firms and a good system to select public investment are all important factors, although there are many more.

Promoting consumption without promoting all the above is putting the cart before the horse. Those who believe that, at present, a widespread and substantial increase in wages in the Spanish economy would be positive for growth are making this mistake. Some companies or sectors will certainly be able to offer considerably higher wages. Nevertheless, with unemployment above 17%, wage containment is still important to promote job creation and maximise growth in household income.

It is also important, in terms of fairness, that the consumption capacity of young people catches up with that of their elders, given that over the past few years the severest wage cuts have tended to affect the younger segments of the population, as well as continuing to reduce their rate of unemployment.

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