Household debt soars in Spain

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12 July 2005

The financial debt of Spanish households has soared, according to the Bank of Spain. Household debt rose above disposable income for the first time in 2004, up from just over half in 1997. Borrowing in Spain has tripled in eight years, rising from €200 billion ($240 billion) in 1996 to reach record levels of €595 billion—equal to 74.5 percent of the country's gross domestic product.

The bank blames the debt mainly on the rising cost of buying a house in Spain, where prices have skyrocketed by 150 percent since 1997. The average cost of a mortgage is now €124,000 ($147,000) whilst the average wage is €1,400 per month. It warns that many Spaniards are wagering their future well-being on the hope that property prices continue to rise.

The bank calculates that house prices in 2004 were overvalued by 35 percent and warns that Spanish households have now become "more exposed to certain macroeconomic or idiosyncratic shocks, such as those caused by changes in interests, asset prices or household incomes" and that rising household debt could impact on Spain's competitiveness.

It points out that the housing boom was stimulated by relatively high levels of employment, low interest rates, increased access to credit and demand by northern Europeans who regard Spain as the California of Europe.

There could be a slump in house prices if interest rates continue to rise, economic growth slows in Spain, EU subsidies dry up as they are diverted to Eastern Europe and Spanish families reach the limits of their ability to borrow money. The *Economist* notes that the ratio of house prices to income in Spain (average house price divided by average income) is already at its highest level ever and 68 percent above its long-term average. In the United Kingdom, Ireland and the Netherlands the average is 50 percent above its long term average and in the US it is 23 percent above. There are also more than 3 million empty new homes in Spain and owners may try to sell them as they realise that prices are about to come down, causing a further drop in prices.

If there is a plunge in house prices, many people would become bankrupt overnight. This would hit Spain particularly hard, as it has one of the highest rates of owner-occupancy in Europe, standing close to 90 percent.

The massive rise in house price rises is not confined to Spain, but is part of a global phenomenon. According to the *Economist* of June 16, the total value of residential property in developed economies has almost doubled in the past five years to over $70 trillion. It says house prices have risen much more in real terms than during any previous boom and that they have increased relative to incomes and rents. The magazine calls the current situation "the biggest bubble in history," dwarfing the US stock market bubble of the 1920s and the 1990s boom which ended in the dot-com crash in 2000. In an attempt to offset that crash, the US Federal Reserve and other central banks cut interest rates to historically low levels—thus stimulating the housing boom.

House prices in Spain have risen more rapidly than in any other industrialised economy apart from Ireland, where the average cost of houses has increased by 174 percent in the same time period. Prices in the UK and Australia have risen about 115 percent. In contrast, house prices in Germany have remained relatively constant (declining about 3 percent) whilst in Japan they have dropped by 22 percent.

Property accounts for some 40 percent of capital investment in Spain and a large slice of the country's economic growth has been based on the property boom that began in 1996. More houses have been built in Spain than in all the other countries in Europe put together.

The property boom has led to the rapid growth of Spanish property and construction companies. Metrovacesa is now the largest property company in the eurozone and the second largest in Europe, following its recent purchase of French property company Gecina. It was the biggest-ever merger in the property sector in Europe and one of the biggest-ever cross border acquisitions made by a Spanish company. However, Jordi Falgueras, chief analyst at the Barcelona-based fund managers Gaesco, warned, “The whole sector could come to a halt if interest rates go up.”

The massive increase in property prices has hit hardest the poorest families in Spain, where even average households spend 57 percent of their income to buy a house. Those who managed to buy houses at the top of the market and accrued massive debt in order to do are also very vulnerable. Figures released by the National Statistics Office said that only 38.6 percent of households in the last quarter of 2004 had put savings away for an emergency. It also said that over half had difficulties paying monthly bills.

The Spanish Socialist Workers Party (PSOE) government’s social and economic policies have done little to alleviate the problems caused by the rising debt. The 2005 budget was remarkably similar to the last Popular Party (PP) government’s budget, with spending on social welfare increasing only 1 percent on the PP’s proposals—to just over half of government expenditure.

During the election campaign in March 2004, the PSOE promised to deal with two of the problems that most concern Spanish workers—real-estate speculation and the lack of affordable housing. However, plans announced recently by Housing Minister María Antonia Trujillo to construct 180,000 “dwelling solutions” involve providing free public land to property developers to build flats at a price of about €60,000 or the construction of “micro-pisos”—tiny apartments ranging from 25 to 30 square metres.