Spain: Prime Minister Zapatero lashes out at European Central Bank

Keith Lee
5 July 2008

Spanish Prime Minister José Luis Rodriguez Zapatero has lashed out at the European Central Bank (ECB) and its president Jean Claude Trichet.

His anger was provoked by Trichet's statements that he may raise its interest rates this month—a rise of 0.25 percent is widely anticipated—to contain growing inflation within the European Union (EU). Consumer inflation in the euro-zone nations rose at an annual rate of 3.7 percent in May, well above the ECB's target of 2 percent.

"I don't say it's certain," Trichet said, "I say it's possible."

"A very solid anchoring of inflation expectations is essential," Trichet added, making it clear that, despite rising energy and food prices, workers must bear the brunt of the growing economic crisis. The ECB is looking to land the first blow against demands for increased wages.

Urging Trichet to show "a bit more prudence," Zapatero said, "We all respect the independence of the European Central Bank but we all expect the European Central Bank to behave responsibly." He said an increase in the European Interbank Offered Rate (Euribor)—the average interest rate at which 50 of Europe's top banks borrow from one another—was "surely excessive."

Repeating his criticisms later, Zapatero called for "flexibility" from the ECB.

Zapatero's mood was darkened by the political crisis arising out of Spain's growing economic problems, which has led to him being summoned to the country's National Congress to explain what is happening and what he is doing about it. The appearance has few precedents.

Trichet dismissed Zapatero's pointed criticism, saying the ECB would not be pressured by politicians. "Everybody knows that we are independent," he declared. "Everybody knows that this independence is totally guaranteed by the treaty." After his remarks oil prices rose sharply and the Euribor rate went up.

The blunt character of Zapatero's remarks reflects increasing differences between the European powers over what policy to pursue in the face of the growing economic crisis.

The Spanish government has in the past said that it would like the ECB to lower interest rates and that it was unhappy with the high euro-dollar exchange rate. Zapatero was not the only European leader to express displeasure at Trichet's remarks. Portuguese Finance Minister Fernando Teixeira dos Dantos said a rate rise would mean "more difficult times" for his country's economy and French Finance Minister Christine Lagarde criticised the ECB for focusing solely on fighting inflation. She warned against "an economic slowdown that could be induced by an interest rate increase."

Trichet has been defended by the German government of Angela Merkel, which demanded an explanation of Zapatero's outburst. Spokesman Thomas Steg said Germany viewed the ECB's independence as untouchable. "We have no criticism to make of the ECB or of Mr. Trichet. If Mr. Zapatero sees this differently, he has to explain that," Steg told a government news conference in Berlin.

Slovenian Finance Minister Andrej Bajuk praised the ECB's independence, calling it "the right system, definitely at this time."

Of all the European economies, Spain is one of the most vulnerable to interest rate rises. Any rate change will have a disastrous impact on the construction industry, which has played a huge role in the national economy and is suffering badly under the credit crunch. House prices have fallen 15 percent since September, according to real estate developers APCE. Some 90 percent of Spanish mortgages are indexed to Euribor rates. Spanish workers who have relied on their properties to supplement their meagre wages will be hit hardest and with over 98 per cent of Spanish mortgages on floating rates, any increase in rates will push many workers further into poverty.

Because Spain has had one of the highest budget surpluses in the industrialised world, government ministers and officials from the ruling Spanish Socialist Workers Party (PSOE) have argued that the country is better positioned than most to weather the financial storm. Zapatero declared during the election campaign in March, "We've saved, we've managed our finances well and we've got a bigger surplus than expected, so we can stimulate the economy and help families."

He made a number of election pledges, including an annual income tax rebate of €400, relief on mortgage payments, a 26 percent increase in the lowest state pensions, and a public works programme aimed at building 150,000 affordable homes a year. The government also promised to invest in major road and rail building programmes, such as the high-speed rail link between Madrid and other regions.

However, within weeks the surplus tumbled as the government tried to compensate for the crisis in property and oil prices. Carlos Ocaña, Secretary of State for Housing, said that for the year to May there was a surplus in state budgets of €2.7 billion, 0.24 percent of GDP, down from €13.6 billion for the same period last year. It will fall even further if the government carries out its election promises.

Many commentators have expressed anger at Zapatero's bullish forecasts and his refusal to give emergency credit to the wider construction sector, which is responsible for a fifth of Spanish GDP, double the average rate elsewhere in the European Union. Spain built more homes than Germany, Italy and the United Kingdom put together and has been more dependent on housing than any Western country except Ireland.

According to Spanish Housing Minister Beatriz Corredor, the residential construction sector is in "a very severe, intense slowdown" and "it has accelerated significantly since the beginning of the year...causing problems for many households with mortgages."

Corredor said Spanish house prices were decreasing in real terms, but refused to say whether they would fall to the extent predicted by the International Monetary Fund (IMF) and other financial institutions. The most recent IMF forecast suggests Spain's economic growth will fall from 3.8 percent last year to 1.8 percent this year, one of the biggest drops among developed nations and that inflation may rise to 4 percent. The country's current account deficit at 9.5 percent of GDP is the second highest in the industrialised world, after the United States.

Corredor refused to be drawn on whether she supported Zapatero's outspoken concerns and although she said it was "not her job" to tell Trichet his responsibilities, said he had "to consider the impact of his statements."

Up to a million job losses are expected in the construction sector this year. According to recently released figures, there are a billion unsold bricks. "Zapatero has hung us out to dry," said Alameda building contractor Luis Ruiz.

Many brickyard owners have rejected Zapatero's claim that the construction-dependent economy can be transformed without suffering high unemployment. Hector de Pinto Sanchez, of the La Alameda brickworks, said that, "85 percent of our workers have little education. What do you think they're going to do if this factory shuts?"

In La Sagra, Spain's largest brick and tile manufacturing region, many towns and villages have become wastelands, with half-built apartment blocks abandoned by building firms that have run out of cash and credit. Nearly a million new Spanish homes stand empty.

Many economists have criticised Spain's reliance on cheap euro-zone credit and low-skill and low-paid employment to drive its growth. "The Spanish economy is in for a ferocious fall," said economics professor Antoni Espasa at Madrid's Carlos III University. "It's going to suffer more than Europe and take longer to recover."

Rafael Pampillon, head of economics at Madrid's Instituto de Empresa business school, added, "We are not shifting to high-skill industries where we can compete. We are in an economic crisis where unemployment is rising."

Zapatero recently announced further measures to pass the current economic crisis onto the Spanish working class. He has declared a salary freeze, and a 30 percent cut in hiring for civil service jobs from next year. The pay freeze will include top governmental salaries, but the brunt will be felt by ordinary workers who earn an average of €17,000 (US$31,000).

Unemployment currently stands at 9.6 percent, and is expected to be nearer 11 percent next year. Minister for Employment Celestino Corbacho has said that, although Spanish pensions are "plainly guaranteed," it will be necessary to think about future provisions.

Miguel Angel Fernandez, Governor of the Bank of Spain, has told Congress that he does not consider Zapatero's economic measures to be adequate and is calling for reform of the labour market, changes to collective wage negotiations that would end the link between salary increases and inflation and greater austerity measures from the Spanish regional governments.

The problem facing Zapatero is the radicalisation of Spanish society—an indication of which were the actions in recent weeks by Spanish fishermen and truck drivers, which threatened to bring the country to a standstill.