Spain: Economy slumps as unemployment hits ten year high

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News that the 15-member euro zone has recorded its first-ever contraction will put greater pressure on an already ailing Spanish economy.

Last week, the European Union statistics office reported that the euro zone had contracted by 1.5 percent year-on-year. Although the European Commission said it was too early to speak of recession, reports that Germany—as Europe's biggest economy—had reported a 0.5 percent quarter fall in GDP for April-June only deepened the gloom.

The global economic crisis, which began in the United States, was already making itself felt on the weaker euro zone countries such as Greece, Portugal and Spain.

Only last week, Spain's Prime Minister José Luis Zapatero had interrupted his summer holiday and recalled his cabinet to discuss special measures to deal with the country's economic slump. Zapatero's ruling Socialist Workers Party (PSOE) government is in turmoil, having earlier claimed that Spain had weathered the worst of the global credit crunch and dismissing warnings of a crisis as "enormously exaggerated."

Now, there is no denying that the Spanish economy is contracting at record levels and the government and financial institutions are constantly forced to revise their forecasts.

Things have gotten so bad that *El Pais*, the newspaper most closely aligned with the Spanish Socialist Workers Party (PSOE) government led by José Luis Zapatero, declared recently, "What happened? How did we pass from Heaven to Hell?" Of course, it should be remembered that the period *El Pais* calls "Heaven" would only have been described as such by a small elite that accumulated its fabulous wealth at the expense of the impoverishment and indebtedness of millions of working people and their families.

Spain's current account deficit—now 10 percent of GDP—is the world's second biggest after the US. The budget surplus that last year stood at €23.4 billion (US$35 billion), the second highest in the euro zone, has crashed to a deficit of nearly €5 billion (US$7.4 billion).

The PSOE government has been thrown into turmoil because the surplus was regarded as the war chest that would see the country through economic difficulties. According to Finance Minister Pedro Solbes, the economy will shrink from 3.8 percent growth in 2007 to 1.6 percent this year and 1 percent in 2009, although he also warned that it could hit zero. The annual rate of inflation rose to 5.3 percent, the highest level since 1993, according to government statistics, and debt defaults have risen 172 percent in the second quarter.

Nearly half of defaults are in the property sector, which made up 18 percent of GDP last year and was a major factor in Spain's economic growth. Latest statistics show a drop of more than 78 percent in house sales and an 87 percent decline in company profits. The price of existing homes fell nearly 5 percent in the first seven months of 2008—down to their January 2006 level. Fernando Herrero, vice president of the bank client association Adicae, warned that up to 120,000 families could soon default on their home loans.

In early July, real estate company Martinsa-Fadesa became Spain's biggest-ever corporate collapse after it failed to secure a €150 million loan as part of a refinancing package for debts worth €7 billion. The company had lost €85 million (US$126 million) in the first quarter of this year, compared to profits of €413 million (US$612 million) in the same period of 2007.

Alejandro Varela, a fund manager with Madrid brokerage company Renta 4, said, "If this happens with one of the big ones, who knows what is happening with medium- and small-size promoters."

"The problem is debt. These are companies that grew very fast thanks to very generous financing from the banking sector," he added.

Martinsa-Fadesa chairman Fernando Martín claims that the government had promised the company a loan from the Official Credit Institute to help with debt refinancing. However, the government denied this. The governor of the Bank of Spain, Miguel Ángel Fernández Ordóñez, said, "If [the loan] had been granted, other companies with similar problems would start lining up."

The implications of the collapse of Martinsa-Fadesa are working their way through the rest of the Spanish economy. In the days following, the Madrid stock exchange suffered what Solbes called an "earthquake"—crashing 27 percent. At the end of July, the *Financial Times* remarked that the collapse was "a reminder, if any were needed, of the massive scale of the Spanish property crash. Serious financial and economic distress is almost inevitable. Do not be fooled by the fact that Spanish banks had virtually no exposure to US subprime mortgages. Being exposed to Spanish mortgages is probably worse."

Morgan Stanley has also issued a major alert on the health of Spanish banks, which have insisted up to now they can weather the storm. Three of the country's leading retail banks—Bankinter, Banco Popular and Banco Sabadell—reported a sharp increase in bad loans in the first half of 2008.

Spain's manufacturing sector was already shrinking fast, before the latest reports on the euro zone economy. The Institute of Economic Studies in Madrid said the June production figures provided further evidence "the crisis goes well beyond the construction sector. This is very negative data that shows that inflation is starting to have a second round of effect." Industrial output has fallen by a record 9 percent—the biggest in the indicator's eight-year history and in the automobile industry a 30 percent fall in sales was recorded in June.

Retail sales have fallen nearly 8 percent in 2008, signifying the worst performance since Spain began registering the results in 2004. "This is retail sales falling off a cliff," said analyst Daniel Antonucci at Merrill Lynch. "At the very best, the Spanish economy is stagnating."

El Pais reported, "The overall conclusion in the international business world is that Spain is heading downhill fast, its economy reeling from the bursting of the real estate bubble amid a global credit crunch as the spectre of rampant inflation fuelled by soaring fuel and food prices looms increasingly large. Some companies wrap their worries about Spain in euphemisms: 'Spain is the country facing the most challenging situation'..... Others are much more blunt, singling Spain out as the weakest link in their business."

"From carmakers and cement manufacturers to tour operators and white goods distributors, virtually every big multinational is feeling the pinch from its Spanish operations. Renault, Volkswagen, Honda, Ford, Cemex, ABB, Ericsson, Philips, Avis, Royal Caribbean and Danone are just a few of the companies that have blamed Spain for some of their troubles. Most of their comments had little immediate impact, but in the case of Vodafone, the company's admission of its problems in Spain caused its share price to plunge."

Many of these companies are cutting their workforces. The French glass and construction materials company Saint-Gobain said it will sack 1,500 workers due to the collapse of the construction industry. The CEO of Spainair, Marcus Hedblom, announced the loss of 1,193 jobs from its total workforce of 3,800. Hedblom is demanding major sacrifices by the workers warning that "If we don't [reach an agreement]...the company will not survive."

Unemployment now stands at 10.4 percent—the second-highest level in the European Union—and represents a dramatic change from the days, not so long ago, when Spain was creating roughly a third of all new jobs in the euro zone. New jobless claims normally fall in Spain during July, but this year they rose 36,492 to a total of 2.43 million. Spanish bank BBVA predicts that unemployment could rise by up to 14 percent by the end of 2009.

Joblessness is rising three times faster among immigrant workers, 4 million of whom arrived in Spain in the last decade to work in the construction industry and other services. Over the last four years, they have been responsible for borrowing about €172 billion—nearly a third of all lending.

In January of this year, the government had announced a package of measures worth €18 billion (US$28.5 billion) which would supposedly stimulate growth, such as a small income tax rebate and procedures to make it easier to set up new businesses.

With these having patently failed, Zapatero's special cabinet meeting discussed a new package, including the abolition of inheritance tax, implementing an EU directive to open up the services sector and cutting red tape for small and medium-sized businesses.

These measures are seen as merely scratching the surface by economists and bankers who are calling for drastic attacks on the wages and conditions of the working class. The International Monetary Fund has demanded deep cuts in the welfare system and an end to index linked wage increases—demands echoed by the *Financial Times*, which says other EU states should demand that "the beneficiaries end the silly policies that got them into the mess in the first place."