Second recession looms in Spain

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29 December 2011

Economy Minister Luis de Guindos warned on Monday that Spain's economy had suffered a "relapse" at the end of this year, and that the renewed weakness would continue into 2012.

"In all certainty, in this quarter the Spanish economy has had a relapse, and we will return to negative growth, which will logically determine the shape we are in for next year," De Guindos, former head of Lehman Brothers in Spain, said. "Let nobody fool themselves; the next two quarters from the point of view of growth and from the point of view of employment are not going to be easy."

De Guindos refused to use the word recession, but negative growth in early 2012 on top of the 0.3 percent contraction for the last quarter of 2011 means Spain will officially have slipped back into recession—just two years after climbing out of its last economic downturn, the worst in living memory.

New data from the Bank of Spain shows public debt has risen above the 60 percent European Union limit, to 66 percent of gross domestic product (GDP)—up from 58.7 percent last year.

Spanish debt, coupled with floundering talks between Greece and private bondholders and between Hungary and the International Monetary Fund, prompted the credit ratings agency Fitch to declare last week that a "comprehensive solution to the euro zone crisis is technically and politically beyond reach."

Fitch warned Spain and Italy of a "near-term" downgrade of their creditworthiness, putting them alongside Ireland, Belgium, Slovenia and Cyprus.

Earlier in December, the ratings agency Moody's put eight Spanish banks on review for possible downgrade and downgraded 21 other Spanish financial institutions. Just before Christmas, the yield on 10-year bonds, which reflects governments' real cost of borrowing, hovered around 5.4 percent.

De Guindos took office last week as a minister in the new right-wing Popular Party (PP) government, which came to power after the collapse in support for the Socialist Workers Party (PSOE) in last November's general election. In parliament, PP Leader Mariano Rajoy was sworn in as Prime Minister with 187 votes, 149 against and 14 abstentions. His support came from the PP and the deputies of two small regionalist parties in Navarre and Asturias. The PSOE, United Left and Union, Progress and Democracy and all the regional-separatist parties voted against except for the Basque Nationalist Party, the "left Basque nationalist" Amaiur and the Canarian Coalition, which abstained.

In his inaugural speech, Rajoy vowed to slash the public deficit and bring in more labour reforms, saying they were necessary to calm the financial markets. "We will have to reduce by €16.5 billion ($21.5 billion) the shortfall between revenues and spending for the whole public administration", he declared.

Rajoy has pledged to cut Spain's budget deficit from 11.2 percent of GDP in 2009 to within the European Union limit of 3 percent by 2013.

In his speech, Rajoy promised to create jobs, cleanse the banking system of its toxic assets, eliminate bureaucracy, restore Spain's international reputation, cut taxes for businessmen, bring back tax deductions for house purchases and reduce the number of public holidays. However, his keenly awaited speech did not respond to the expectations of the international financial markets, which criticised the measures as too vague.

El País, the former supporter of the PSOE, supported demands for greater cuts, stating in its editorial, "Overall, Rajoy did his best to stick to the rhetoric he used in his campaign, hoping not to alienate any sector of opinion by means of saying nothing specific about what he plans to do. This is a risky line for the Popular Party to take, because sooner or later it will have to govern. But it may also be risky for the country as a whole, if vagueness eventually translates into inaction."

The *Economist* commented, "His eagerly anticipated speech to parliament contained little more than broad brushstrokes and some rather obvious objectives."

The *Financial Times*'s Madrid-based correspondent Victor Mallet criticised Rajoy for the fact that "he gave few details of the bank reforms" needed to tackle the parlous state of Spanish banks, which are still reeling from the collapse of the property boom. In the third quarter real estate prices decreased around 7.4 percent compared to the same period a year ago.

According to the *Wall Street Journal*, "Spanish banks hold over €400 billion ($520 billion)—equivalent to 40 percent of Spain's gross domestic product—in loans to the construction and real-estate sector, backed by collateral that loses value as property prices slide further. In addition, the central bank estimates that around €180 billion in loans to builders and developers is 'potentially problematic'."

Rajoy has talked of creating a "bad bank" to absorb toxic assets, but his proposal is not accepted by all his new ministers. De Guindos and Foreign Minister José Manuel Garcia Margallo are in favour, while Treasury Minister Cristobal Montoro disagrees, proposing instead more mergers within the Spanish financial sector.

The "bad bank" would free the banks and savings bank (*cajas*) of their burden of bad loans and allow them once again to be able to trade and speculate freely. The whole circus of financial speculations that led to the financial crisis in the first place could thus recommence, as if nothing had happened.

The deteriorating economic situation in Spain is having a catastrophic effect on living standards. Workers are being made to pay for the crisis through unemployment standing at 23 percent and 48 percent amongst youth. In addition, 60 percent of Spanish salaried workers earn less than €1,000 a month.

Living standards are bound to drop further, as the government implements its labour reforms. Labour laws are routinely described as too "rigid" and there are non-stop demands to cut severance pay, salaries and benefits. One of the government's first measures was a freeze on filling new civil service vacancies. It has set a January 7 deadline for employers and unions to agree on a labour reform programme.