Inside Spain Nr 102
(18 December 2013-28 January 2014)
William Chislett

Summary

Rajoy in first official visit to US touts Spain's exit from recession.
Panama Canal expansion dispute becomes an affair of state.
Abortion bill backlash takes a toll on the ruling Popular Party.
Economy expands at fastest pace in six years, IMF raises growth forecasts.

Foreign Policy

Rajoy in first official visit to US touts Spain's exit from recession
Prime Minister Mariano Rajoy met President Barak Obama in his first official visit to the White House since taking office two years ago and concentrated on 'selling' the improved prospects of the Spanish economy.

Obama hailed the government's reforms but said Spain still faced 'enormous challenges' in reducing a jobless rate that stands at 26%.

At a luncheon with the US Chamber of Commerce in Washington, Rajoy gave a speech titled 'Back to Growth, Ready for Jobs'.

Rajoy told Obama that Spain fully supported the free-trade agreement being negotiated between the EU and the US. The US is Spain's main export market outside the EU (around 5% of total merchandise exports). These exports amount to more than the sum total of those to the next four countries in the Americas (Mexico, Brazil, Venezuela and Canada).

Between 2005 and 2012, the portfolio of direct Spanish investments in the US grew by 630% to US$47.3 billion. Spain is the 10th-largest overseas investor in the country (1.8% of the total). Over 700 Spanish companies have invested in the US and employ more than 70,000 people.

The US is the second-largest investor in Spain and the sixth-biggest supplier of goods.

The US government has asked Spain for permission to expand its 500-strong Marine rapid-reaction force for Africa by at least 50% and extend its presence at the Morón de la Frontera base by one more year.

A bilateral agreement allows the US to temporarily station its Marines at the airbase, which provides fast access to the Mediterranean region. The Spanish government first authorised the deployment of Marines and aircraft to the airbase last April as part of a rapid-reaction strategy against crisis situations in Africa. The initiative was triggered by the September 2012 attacks against the US consulate in Benghazi, Libya.

Panama Canal expansion dispute becomes an affair of state
The Spanish-led construction consortium leading the expansion of the Panama Canal, which had threatened to halt work on 20 January over a dispute on a €1.2 billion cost overrun, agreed to extend its deadline for a work stoppage until 1 February.

Resolving the dispute over this showcase project, a landmark deal for the internationalisation of the Spanish construction sector, has become an affair of state for Madrid. At stake is the reputation of Spanish expertise in big infrastructure projects. Many companies are working around the world on diverse projects.

The Public Works Minister, Ana Pastor, was quick to visit Panama in early January and meet the Panamanian President Ricardo Martinelli after the consortium, headed by Sacyr, made the announcement. The European Commission agreed to mediate the conflict.

The consortium Grupo Unidos por el Canal (GUPC), which includes Italy's Impregilo, the Belgian firm Jan De Nul and the Panamanian company CUSA, and the Panama Canal Authority (ACP) each blame the other for the overruns. GUPC, which blames the ACP for conducting faulty terrain studies, wants the ACP to assume the costs of continuing the expansion.

US diplomatic cables published by Wikileaks showed the Panamanian government was worried about progress before six months had passed.

Sacyr won the canal contract in 2009 with an offer considerably below the main rival bids and also below the US$3.48 billion reference set by the canal authority. It was suspected that Sacyr would then seek to renegotiate the contract upwards.

Domestic Scene

Abortion bill backlash takes a toll on the ruling Popular Party (PP)
The government's abortion bill, which rolls back current legislation, is opposed by a majority of people including a high proportion of the ruling PP's supporters, according to an opinion poll conducted by Metroscopia.

The bill no longer allows the procedure on demand until the 14th week. In most EU countries, abortion is a right in the first weeks of pregnancy. If passed by parliament, where the PP has an absolute majority, Spain would become the first member of the EU to retreat from a decades-long trend toward safe and legal abortion.

Abortion would only be permitted in the case of rape or where there is a serious mental or physical health risk to the mother. Fetal deformity would no longer be allowed as a reason to request an abortion; the only valid reason is if it is 'incompatible with the life' of the baby. To request an abortion, a woman would need the approval of two doctors outside the clinic treating her and would have to observe a seven-day reflection period.

Alberto Ruiz-Gallardón, the Justice Minister, said that 16- and 17-year-olds will once again have to obtain permission from their parents for an abortion. This is the most controversial part of the current legislation, approved by the previous Socialist government in 2010 to the fury of the country's Roman Catholic Church hierarchy, which the PP appealed against to the Constitutional Court.

Eighty-six per cent of respondents said women should have the right of choice, 96% of whom said they were Socialist voters and 68% PP, while 84% said that in the case of fetal deformities abortion should be allowed as at present (95% Socialist voters and 70% PP).

The Socialist party said it would overturn the law if it wins the next election. Some PP leaders are also unhappy with the restrictions, such as José Antonio Monago, the president of the region of Extremadura, who believes it would be better to await the decision of the Constitutional Court and forge a consensus and greater social support for any changes to the law.

The PP's Celia Villalobos, parliament's deputy speaker, appealed for her party's legislators to be allowed to vote freely on the bill rather than according to the party line.

The reforms have also drawn criticism from some foreign governments. Najat Vallaud-Belkacem, France's Minister for Women's Affairs, said she was 'deeply concerned'. She told French media: 'It is terrible to see how a country like Spain, which in recent years has been something of a leader in the battle against domestic violence... is planning to take a step back when it comes to the rights of women over their own bodies'.

There were 112,390 abortions in 2012, up from 411 in 1986, the first year after legislation was passed. Before then, London was the favoured place by Spanish women for abortions. Some doctors have voiced concerns that the new abortion law will force women to go abroad again.

ETA moves closer to a definitive end to its more than 40-year conflict

The violent Basque separatist organisation ETA moved a little closer to bringing its more than 40-year long campaign to an end when a group representing more than 500 jailed terrorists said it was prepared to accept the legitimacy of the convictions made by judges against them.

Until then, ETA, whose actions have claimed the lives of more than 800 people, had sought an amnesty.

'As part of a process to return us to our home –our release from prison and, as a first step, our return to the Basque Country– we could accept the use of legal means even if this means our implicit acceptance of our sentences', said a statement which recognised the 'suffering and harm' inflicted.

The prisoners' move was backed by the more than 60 ETA prisoners recently released after the European Court of Human Rights struck down a controversial procedure, known as the Parot doctrine, which prevented the early release of prisoners, mostly ETA activists convicted of the most serious crimes.

These ex-prisoners, who between them were responsible for 300 deaths, met in public in Durango to the disgust of the Association of Terrorism Victims and the government, which called the meeting a 'witches' sabbath'.

More than 100,000 people subsequently marched through Bilbao in support of imprisoned ETA members, defying a Madrid court ban. One of their demands is that prisoners should be moved closer to their homes so that family members can visit them more easily.

In a policy departure, the moderate Basque Nationalist Party (PNV), which rules the region, joined forces in the rally with the openly pro-independence Sortu in a rare instance of unity. The PNV believes the ruling PP should show some flexibility now that ETA's imprisoned members accept that they are common and not political prisoners.

The PNV took the first step toward seeking a 'new political status' by registering in the Basque parliament a report on self-government to be debated. The Basque Country has the greatest degree of autonomy among Spain's 17 regions. A previous move in this direction in 2004 for a 'free association' of the Basque Country with Spain was voted down by the national parliament.

The PP, backed by the main opposition Socialist party, believes the only genuine signal from ETA will come when the group lays down its arms and formally disbands. Eta announced an 'indefinite' ceasefire more than two years ago, but has yet to meet the government's demands.

ETA has been considerably weakened by arrests of activists in Spain and France. Eight suspected ETA members were arrested earlier this month in the Basque Country and Navarre. Among them was Arantza Zulueta, a lawyer representing various ETA prisoners.

Catalan parliament makes another move over independence referendum
The Catalan parliament voted overwhelmingly in favour of sending a petition to the national legislature in Madrid requesting a referendum on independence for the region.

The move won 87 favourable votes from the nationalist Convergence and Union (CiU) coalition, the openly pro-independence Catalan Republican Left (ERC), two small parties and three Socialist deputies who broke ranks. The Popular Party (PP), the Socialist party and Ciutatans garnered 43 'no' votes.

The PP government in Madrid has made it crystal clear on many occasions that such a referendum is unconstitutional.

Meanwhile, Artur Mas, the premier of Catalonia, sought international support for the referendum by writing to EU heads of government. He reportedly has received no support.

King's youngest daughter to testify over tax fraud and money laundering
The Infanta Cristina, the youngest daughter of King Juan Carlos, became a formal suspect in the long-running investigation into the business affairs of her husband after she was summoned to appear in court over accusations of fraud and money-laundering.

Palma de Mallorca Judge José Castro ordered the Infanta to appear for questioning about her partnership with Iñaki Urdangarin, the Duke of Palma, in a firm called Aizoon, despite objections from the anti-corruption prosecutor, Pedro Horrach, who said he saw no evidence linking her to her husband's alleged wrongdoing.

A previous attempt last April by Castro to have her appear in court was blocked by the provincial court in Palma de Mallorca. She would have been questioned about the Noos Institute, a charitable institution that her husband headed. It received millions of euros in public funds, which were allegedly embezzled.

The new court summons relates to suspicions that Aizoon served as a vehicle for money laundering.

The Infanta Cristina's lawyers said they would not appeal the court summons because they wished to avoid any further 'collateral damage' to her image and that of the rest of the royal family and to raise objections would prolong the 'uncomfortable and unjust' situation. She is due to appear on 8 February.

Opinion polls show that the monarchy's popularity has been eroded by the scandal.

The Economy

Economy expands at fastest pace in six years, IMF raises growth forecasts
Spain is finally on the road to recovery, albeit timidly. The economy grew by a meagre 0.3% in the fourth quarter of 2013 over the previous quarter, the fastest pace of growth in six years and three times higher than in the third quarter. Growth for the whole year, however, was 1.2% negative.

The IMF raised its growth forecast for 2014 from 0.2%, made last October, to 0.6% (still below the government's figure of 0.7%).

'For the first time since the start of the crisis, we are in a different scenario', Luis de Guindos told parliament. '2012 was the year of adjustment, 2013 of reforms and 2014 of recovery', said Prime Minister Mariano Rajoy.

Unemployment is beginning to fall slightly (see next item) and the risk premium of the 10-year Spanish government bond over the benchmark German equivalent has declined (see Figure 1). Demand for these bonds surged this month. The Spanish two-year bond spread over Germany was back last week to its lowest level since before the first bailout of Greece, in April 2010.

Figure 1. 10-year government bond yields (%) and spreads over Germany's bunds (1)

	Yield 25 January 2013	Yield 28 January 2014
Germany	1.64	1.68
Greece	10.49 (8.85)	8.65 (6.98)
Ireland	4.11 (2.47)	3.45 (1.78)
Italy	4.14 (2.50)	3.85 (2.18)
Portugal	6.18 (4.54)	4.93 (3.25)
Spain	**5.18 (3.54)**	**3.74 (2.06)**

(1) Spreads in brackets in pp.
Source: ThomsonReuters.

In a further sign of international confidence, Bankia, the banking group that collapsed at the height of the eurozone debt crisis, launched its first senior unsecured bond since a government bailout in 2012.

Other positive news included:

- Exit as of 23 January from the European Stability Mechanism's US$41 billion bailout of some ailing banks hit by the construction boom-and-bust.
- The annual rate of inflation was 0.3% in 2013 (0.8% in the euro zone).
- The number of tourists was a record 60.6 million in 2013 (+5.6%), enabling Spain to recover its third position in the world ranking by number of visitors. It was pipped to the post by China in 2012. Not only did the number of visitors increase, they also spent more. Receipts in the first 11 months amounted to a record €55.9 billion.
- New passenger car sales, spurred by a renewed bonus scheme, rose 3.3% in 2013 to 722,703 units, albeit from a depressed 2012 when the number sold was the lowest since 1986. In 2007, before the crisis, 1.6 million were sold.
- The current account recorded a surplus of €4.2 billion in the first 10 months, thanks to the much lower trade deficit (-64%), due to higher exports, much lower imports and significant foreign capital inflows. The surplus for the whole year estimated at around 1% of GDP will be the first one since 1986.
- Spain's external debt at the end of September stood at €1.66 trillion, the lowest level since the middle of 2008, largely as a result of deleveraging by the banks, according to the Bank of Spain. As a percentage of GDP, it stood at 163%, down from 171%.
- Business activity in the services sector picked up. The purchasing managers' index (PMI), complied by data company Markit, increased to 54.2 in December from 51.5 in November. This was the fastest pace of growth since July 2007 and a brisker pace than Germany. The threshold that implies expansion is 50.

The weakness of the recovery is underlined by the household savings rate which fell to its lowest level on record in the third quarter of 2013. The moving average from the fourth quarter of 2011 to the third quarter of 2012 was 0.6 pp lower than the previous three-month period at 8.8%, according to the National Statistics Office (INE). High unemployment and wage deflation have forced families to assign more of their disposable income to consumption and less to savings.

Spaniards have been remarkably resilient in the face of falling living standards, but sometimes political insensitivity can spark unexpected protests. The mayor of Burgos, a conservative city long run by the PP, was forced to back down on a €8 million project to turn a street into a boulevard and build a €5 million underground car park after residents went on the rampage for several days. There were protests in support in 30 other cities including Madrid and Barcelona. Residents would have lost their free street parking. The project was hardly a priority in a city that has suffered spending cuts.

The country's net external debt position rose to 95% of GDP at the end of September, up from 87% at the end of 2012. The non-performing loans of banks' surpassed 13% of total lending in November, a new record. The rise of 0.8 pp was the smallest in the last six months.

The Spanish stock market started the year in a buoyant mood, after rising the most in 2013 among the main European markets after Germany, but its bull run was cut short last week as a result of Argentina's currency woes.

Several of the big Spanish companies that are part of the benchmark Ibex-35 index and are exposed to Argentina, such as Telefónica, Indra, BBVA and Mapfre, suffered big falls in their share prices and dragged down the index. The index fell 5.7% between 20 January and 24, wiping out the gains until then.

Figure 2. Main stock market indices (% change), 2013 and 1-27 January, 2014

	2013	28 January 2014
Ibex-35 Spain)	**21.2**	**-0.4**
Dax (Frankfurt)	25.5	-1.5
FTSE 100 (London)	14.1	-2.6
Euro Stoxx 50	17.6	-2.2
Dow Jones	25.9	-3.9
Nikkei (Tokyo)	56.7	-8.0

Source: Markets.

Unemployment edges down, OECD lauds Spain's labour market reforms

The number of people registered as unemployed (jobseekers) fell in December by 107,000 to 4.7 million, the biggest fall in that month since this data series began 16 years ago. The decline for the whole year of 147,385 was the first full year calendar drop since 2009.

However, according to the other measure of unemployment –a quarterly household survey– and the one used internationally the total number of jobless was 5.89 million at the end of 2013. This was 69,000 fewer than in 2012 and 26% of the work force, the highest rate in the EU after Greece. The unemployment rate for non-Spaniards was 36% (mainly non-EU immigrants). More than 3 million people have been unemployed for more than a year and close to 700,000 households have no members working.

The difference between the stated and registered figures is due to factors such as people not registering in the government's offices after their unemployment benefit runs out and those working in the unofficial economy.

A total of 3.6 million jobs have been lost since the crisis began in 2008, mostly in the construction sector, which was the motor of the economy (see Figure 3). The economic model was excessively based on this sector.

Figure 3. Employment in Spain by sectors, 2007-13 (million jobs)

	2007	2008	2009	2010	2011	2012	2013
Services	13.47	13.78	13.43	13.40	13.39	12.95	12.69
Industry	3.26	3.19	2.77	2.61	2.55	2.43	2.29
Construction	2.69	2.45	1.88	1.65	1.39	1.14	1.01
Agriculture	0.90	0.81	0.78	0.79	0.76	0.75	0.74
Total jobs	20.35	20.25	18.88	18.45	18.10	17.28	16.75

Source: INE, based on labour force survey.

The government's package of labour reforms, which came into force almost two years ago, has not stopped the number of employed from rising. There were almost a quarter of a million more unemployed workers at the end of 2013 than in the first quarter of 2012.

Nevertheless, the first in-depth study of the reforms by the Organisation for Economic Co-operation and Development (OECD) said they marked a 'significant step in the right direction' and had 'contributed to save jobs'.

The reforms cut severance pay for permanent workers from 45 days of wages for each year of service to 33 days, and the maximum amount from 42 months' salary to 24 months. It also introduced a series of so-called 'objective causes' such as falling sales and technological and organizational changes that allow companies to lay off workers en masse with severance pay of only 20 days' wages for every year worked, up to a maximum of one year's salary. Companies were also given more flexibility to depart from collective wage deals and make individual agreements.

Jobs are no longer being shed in public administrations while construction continues to bear the brunt of employment losses. The number of social security contributors in the construction sector alone has fallen by more than 1.5 million since the crisis began. Thanks to a good olive harvest, more people were working in agriculture in December.

Job creation, however, remains precarious; 35% of total contracts are temporary compared with 25% in 2008 and their average duration has dropped from 78 days to 55. The average rise in salaries agreed in collective bargaining last year was 0.57%, and more than 40% of agreements saw a freeze or a drop in pay.

Spain's unit labour costs (ULCs) fell by an estimated 2.6% in 2013 and are forecast to decline a further 1.3% this year (see Figure 4). Spain is one of the very few countries whose ULCs are continuing to fall, restoring the lost competitiveness.

Figure 4. Unit labour costs in 2013 and 2014 (annual % change)

	2014 (1)	2013 (1)
Germany	+1.7	+2.2
UK	+1.2	+1.6
France	+1.2	+1.5
Poland	+1.1	+1.9
OECD average	+0.8	+1.1
Italy	+0.1	+1.7
Spain	**-1.3**	**-2.6**

(1) Estimates for 2013 and forecasts for 2014.
Source: OECD.

The OECD said the full impact on job creation would depend on complementary reforms in other areas such as product and service markets and there was a need for a greater convergence of employers' costs of termination for permanent and temporary contracts. It also recommended that the government rein in the discretionary power of labour courts to declare dismissals null and void to 'extreme cases'.

Jeroen Dijsselbloem, the president of the Eurogroup, called for the government to undertake a second round of labour-market reforms in order to strengthen the country's recovery from a deep recession.

Spain falls in Heritage's Index of Economic Freedom

Spain fell from 46th to 49th position out of 165 countries in the 2014 Index of Economic Freedom, an annual index and ranking created by the Heritage Foundation, a conservative US think tank, and the *Wall Street Journal* in 1995. The country has fallen in the ranking continuously since 2011.

The country is in the group of countries ranked 'moderately free'. Its score in the latest index of 67.2 out of 100 was 0.8 points lower than last year and the second-lowest in 10 years. It continued to score below the world average in fiscal freedom, government spending and labour freedom.

The index is based on four areas (rule of law, government size, regulatory efficiency and open markets) comprising 10 freedoms: property rights, freedom from corruption, fiscal freedom, government spending, business freedom, labour freedom, monetary freedom, trade freedom, investment freedom and financial freedom.

Over the 20-year history of the index, Spain has improved its score by 4.4 points (see Figure 5).

Figure 5. Long-term score change since 1995

Category	Improvement in score (points)
Rule of law	
Property rights	0
Freedom from corruption	+12.6
Government size	
Fiscal freedom	+8.7
Government spending	+1.9
Regulatory efficiency	

Business freedom	+7.3
Labour freedom	+3.4
Monetary freedom	+4.1
Open markets	
Trade freedom	+10.0
Investment freedom	+10.0
Financial freedom	0

Source: Heritage Foundation.

Stock of New and Unsold Homes Drops Below 600,000

The number of new and unsold homes dropped in 2012 to below 600,000 for the first time since 2008, the year when Spain's property bubble burst, according to the Development Ministry (see Figure 6).

Figure 6. Stock of New and Unsold Homes, 2005-2012

2005	2006	2007	2008	2009	2010	2011	2012
195,184	273,363	413,642	583,033	649,780	642,793	626,670	583,453

Source: Development Ministry.

The figure excludes properties in the hands of the 'bad bank' Sareb which houses banks' toxic assets. Including these properties and second-hand ones for sale, the total stock of unsold homes is estimated at up to 1.3 million.

This gradual improvement in the housing glut was not due to a significant rise in sales, but to a sharp drop in finished homes. The number of properties sold in 2012 was 8.5% less than in 2011 at 89,800 and the number that came on the market was reduced by half to around 46,000.

Three of Spain's 17 regions –Valencia, Catalonia and Andalucía– accounted for almost half of the total stock.

In a separate but related property development, Santander, the euro-zone's largest bank by market capitalisation, reached an agreement with Apollo Global Management to sell 85% of Altamira, a unit that handles loan recoveries and markets real estate, for close to €700 million.

The real estate crash left Spanish banks with more than €180 billion of souring assets and the task of managing property piling up on their balance sheets.

Spain's house prices have dropped by 30% on average since the first quarter of 2008, the largest drop in Europe after Ireland, according to The Economist house-price indicators (see Figure 7). Real-estate experts say prices will have to drop further in order to clear the backlog of unsold homes.

Figure 7. The Economist house-price indicators (% change)

	On a year earlier	Since Q1 2008
US	+13.6	-5.9
Germany	+8.1	+25.2
Ireland	+5.6	-45.3
Britain	+5.5	+1.7
France	-1.5	-0.4
Spain	**-5.3**	**-30.0**
Italy	-5.9	-12.2

Source: The Economist and others. 2 January 2014.

Minimum wage frozen
The government froze the minimum monthly wage at €645.3, after increasing it by 0.6% in 2013 (see Figure 8). Workers receive 14 payments, which leaves the annual amount at €9,034.2 (€752.8 a month).

Figure 8. Spain's minimum monthly wage, 2002-14 (1)

	Minimum monthly wage (€)
2002	515.9
2004	537.2
2006	631.0
2008	700.0
2010	738.8
2012	748.3
2013	752.8
2014	752.8

(1) Based on 14 payments a year.
Source: Spanish government.

Spaniards work longer hours than Germans
Spaniards worked on average 1,686 hours in 2012, almost 300 more than Germans, according to the latest OECD statistics (see Figure 9).

Figure 9. Annual number of hours worked in OECD countries in 2012

	Hours
Greece	2,034
Poland	1,029
OECD average	1,765
Italy	1,762
Spain	**1,686**
UK	1,672
France	1,479
Germany	1,397

Source: OECD.

Wind power, the main source of electricity in 2013
Wind turbines met just over 21% of electricity demand in Spain last year, narrowly beating nuclear reactors (21%) and becoming the main source for the first time, according to Red Eléctrica, the national grid.

Total renewable sources (wind power, solar PV and solar thermal) accounted for 49.1% of total installed electricity capacity.

Corporate Scene

Venezuelan Bank Buys Nationalised Galician Bank
Venezuela's Banesco acquired NCG Banco for €1 billion from the government's Fund for Orderly Bank Restructuring (Frob).

NCG Banco, based in the northern region of Galicia, a traditional stronghold of the ruling PP, was one of three nationalised banks still in state hands. The other two are Catalunya Banc and Bankia.

The government injected close to €9 billion into NCG Banco, leaving the state with a big loss.

Banesco outbid Spain's three largest banks, JC Flowers, the US private equity house, and US investors Guggenheim Partners. Under the rules of the auction, the winning offer had to be at least €200 million more than the next-closest bid.

Santander's US auto finance unit raises US$1.8 billion in listing
Santander Consumer USA (SCUSA), a provider of auto loans, raised US$1.8 billion from an initial public offering on the New York market. The company, which is controlled by Santander, sold a 21.5% stake.

The offer was 10-times oversubscribed and generated a capital gain of €740 million, which Santander will use entirely to strengthen the balance sheet.

Santander sold a 4% stake, reducing its holding to 60.7%. The rest was sold by Auto Finance Holdings Series.