Inside Spain 75

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Foreign Policy

Merkel Hails Rodríguez Zapatero's Banking and Economic Reforms

Angela Merkel, Germany's Chancellor, met with José Luis Rodríguez Zapatero, her Spanish counterpart, and praised the government's reforms to shore up the banking system and reform the pensions system.

'Spain has done great things and succeeded with reforms to put the country on a much more positive path', said Mrs Merkel, who arrived shortly after the government, trade unions and employers agreed a social pact including pension reforms.

Merkel's visit also coincided with the announcement of an agreement between the German and Spanish employment services, via the network of EURES, the European Job Mobility Portal, to facilitate more actively the hiring of skilled Spaniards to work in Germany. This does not mean, however, that Spaniards will be given preference over other EU countries.

The German Embassy in Madrid said on its website that qualified Spaniards, with at least an intermediate level of German, were needed to work in the health, engineering, teaching, hotel trade and tourism sectors. Both the Embassy and the EURES office in Madrid were flooded with telephone calls.

Spain's unemployment rate of 20.3% (4.7 million people) is the highest in 13 years, while Germany's at 7.4% (3.1 million) is the lowest in 18 years. Spain urgently needs to create jobs for an economy which is very slowly emerging from recession, while Germany's economy is growing strongly again and has job shortages in key sectors. The German economy expanded 3.6% in 2010 and the Spanish economy shrank by 0.1%.

The programme, the first mass recruitment of Spanish workers for Germany of its kind, evoked comparisons with the mass emigration of Spaniards in the 1960s when entire families left to work in northern Europe. According to the recruitment agency Adecco, 110,000 people left Spain in the two years from April 2008 to work abroad. Most of them were under the age of 35.

Merkel and Rodríguez Zapatero said in a joint press conference that Egypt needed a peaceful transition to democracy as soon as possible.

Domestic Scene

Banned Batasuna Launches New Party to Contest Municipal Elections
Batasuna, the Basque party outlawed in 2003 for its ties to the terrorist group ETA, launched a new party, which it hopes will regain legal status and be able to participate in May's local elections.

Rufi Etxeberría, the leader of the new party, called Sortu, said it 'rejects and opposes the use of violence…or the threat of violence for political objectives, and that includes violence of any kind by ETA'.

The statutes represented the clearest break yet between ETA, which has assassinated more than 820 people in its violent 43-year campaign for an independent Basque Country, and its political allies. Sortu, however, did not call for the disbanding of ETA.

There was no reaction from ETA, whose activists are reportedly divided over whether to lay down their arms and join Sortu in pursuing the cause of independence through democratic channels.

Sortu's statutes were being scrutinised by the Interior Ministry as of 9 February to see whether they accord with the principles of democracy and Spain's law on political parties. Alfredo Pérez Rubalcaba, the Deputy Prime Minister and Interior Minister, said the party's legalisation would be decided by the Supreme Court, the same body that proscribed Batasuna (a decision supported by the European Court of Human Rights in 2009).

'We do not believe it is sufficient to just present some statutes after so many years of violence', said Marcelino Iglesias, the organisation secretary of the ruling Socialist party. 'Although we recognise it is a notable improvement, democracy has to be very demanding with these groups'.

Batasuna's move followed ETA's announcement last month of a permanent ceasefire, its 10th of various types since 1981. The government rejected it as inadequate. 'The only communiqué we want to read from ETA is that ETA declares the end in a manner that is irreversible and definitive', said Pérez Rubalcaba.

The last 'permanent' truce lasted nine months in 2006 and ended with a bomb attack at Madrid's Barajas airport that killed two people.

Big Rise in Muslims in Spain Envisaged
Spain accounted for a significant part of the rise in the number of Muslims in Europe from 29.6 million in 1990 to 44.1 million in 2010, according to the Pew Research Centre (see http://pewresearch.org/pubs/1872/muslim-population-projections-worldwide-fast-growth).

The number in Spain in that period increased from 271,000 to just over 1 million (see Figure 1). Pew estimates the number will reach 1.85 million by 2030 (3.7% of the population).

Figure 1. Muslim Population by Country

	Estim. 1990 Muslim population	% of pop. that is Muslim	Estim. 2010 Muslim Population	% of pop. that is Muslim	Estim. 2030 Muslim population	% of pop. that is Muslim
France	568,000	1.0	4,704,000	7.5	6,860,000	10.3
Germany	2,506,000	3.2	4,119,000	5.0	5,545,000	7.1
Italy	858,000	1.5	1,583,000	2.6	3,199,000	5.4
Spain	**271,000**	**0.7**	**1,021,000**	**2.3**	**1,859,000**	**3.7**
UK	1,172,000	2.0	2,869,000	4.6	5,567,000	8.2

Source: Pew Research Center.

Most of Spain's Muslims come from North Africa, in particular Morocco.

Foreign mothers, in general, are producing more children in Spain than Spanish mothers. The average number of children per foreign mother was 1.65 in the first six months of 2010 compared with 1.32 for Spanish mothers, according to the latest figures from the National Statistics Office (INE). Both figures were slightly lower than a year earlier.

Sharp Fall in Arrivals of Illegal Immigrants by Boat

The number of immigrants from non-EU countries who arrived illegally by boat in 2010 dropped to 3,632 from 7,285 in 2009 and 39,180 in 2006.

Alfredo Pérez Rubalcaba, the Deputy Prime Minister and Interior Minister, said the fall was due to Spain's recession and the consequent lack of jobs and to more effective action by the forces guarding Spain's coastline.

The total number of non-EU immigrants in Spain dropped from 2.56 million at the end of 2009 to 2.39 million last September, according to the latest statistics. Just over 30% of them come from Morocco and 14.3% from Ecuador.

Senate Begins Debates in Five Languages

Spain's Senate, the upper chamber of the parliament, began to allow debates in four languages other than Castilian Spanish: Catalan, Galician, Valencian and Basque.

Critics of the move, mainly in the Conservative Popular Party (PP), whose senators refuse to use any other language but Castilian Spanish, said the senate had been turned into a tower of Babel. 'Something like this would not happen in any normal country', said Mariano Rajoy, the PP's leader.

Those in favour said the Senate was meant to be more representative of the regions than the lower chamber of deputies, and that the languages were accepted as official in four of them.

The cost of the interpreters required is €12,000 for each day of debating, according to the Spanish press.

According to an EU survey conducted in 2005, 11% of Spaniards defined their mother tongue as one of Spain's regional languages.

The Economy

Government, Trade Unions and Employers Agree Pension Reforms and Other Measures

The government signed a pact with the main trade unions and employers' organisation to increase the legal retirement age from 65 to 67, one of the highest in Europe, and raise the number of years from 15 to 25 for calculating state pensions. The three sides also agreed to study changes to the collective bargaining system for economic sectors (giving more flexibility to companies) and to implement measures to foster the creation of jobs for young adults.

The reforms sent a clear signal to the international community of the government's determination to do all within its power to boost confidence in the economy, which has waned in recent months.

The unions had threatened to call a general strike if the government went ahead with its proposals. Prime Minister José Luis Rodríguez Zapatero said they would be approved with or without union backing. After lengthy negotiations, the unions won the concession that workers who have paid into the pension system for 38.5 years will be allowed to retire at 65, amongst others. This affects a small number of people.

Most Spaniards will retire at 67 and 38.5 years of contributions (up from the current 35 years) will be needed to qualify for a full pension. The reforms will be phased in over 14 years starting in 2013.

An ageing population, low birth rates and the very large number of unemployed are straining the social security system, which last year, for the first time, did not run a surplus. According to a study by the Fundación IDEAS, headed by Jesús Caldera, a former Socialist Labour Minister, Spain's pension system would be in deficit as of 2014 (the difference between revenue from contributions and payments), although it would be able to carry on for at least 10 years by using the reserve fund.

The proportion of the population over the age of 65 is forecast to double to 32% by 2050. The old-age dependency ratio (the number of person aged 65 and over as a percentage of the projected number of people aged between 15 and 64) is forecast to increase from 24.4% to 59%, according to Eurostat estimates (see Figure 2). This would be well above the EU-27 average of 53.5%.

Figure 2. Projected Old-age Dependency Ratio (%)

Country	2010	2020	2030	2040	2050	2060
France	25.8	32.8	39.0	44.0	44.7	59.0
Germany	31.2	35.3	46.2	54.7	56.4	59.0
Italy	31.0	35.5	42.4	54.0	59.2	59.3
Spain	**24.4**	**27.4**	**34.3**	**46.4**	**58.7**	**59.0**
UK	24.7	25.6	33.2	36.9	37.9	42.1
EU-27	25.9	31.0	38.0	45.4	50.4	53.5

Source: Eurostat.

The pension reform and the measures to shore up savings banks (see next item) contributed to an improvement in Spain's sovereign risk premium –the spread over Germany's benchmark bonds–. The yield on 10-year government bonds was 5.46% on 14 February and the premium, which denotes international confidence, was 2.17 pp, down from 2.31 pp a month earlier (see Figure 3).

Figure 3. 10-year Government Bond Spreads Over Bunds (pp)

	October 18	November 16	December 14	January 14	February 14
Greece	+6.57	+9.11	8.84	+8.27	+8.25
Ireland	+3.68	+5.82	5.45	+5.49	+5.90
Italy	+1.35	+1.59	1.62	+1.65	+1.53
Portugal	+3.19	+4.21	3.51	+3.84	+4.28
Spain	**+1.63**	**+2.00**	**2.54**	**+2.31**	**+2.17**

Source: ThomsonReuters.

There was also slightly better news on the budgetary and growth fronts. The general government budget deficit for 2010 came in at just below the target of 9.3% of GDP, while GDP growth last year was 0.1% negative, lower than the forecast of -0.3%. The central government deficit was 5.1%, well below the target of 5.9% and offsetting the higher deficits of regional and local governments.

Catalonia's budget deficit hit 3.6% of regional output in 2010, 50% above the limit set for regions by the central government in Madrid. Catalonia alone accounted for €30.3 billion of the total public debt of the 17 autonomous regions of €107.6 billion at the end of last September, according to the Bank of Spain. The previous Catalan government sold €3 billion of one-year bonds to Catalan residents last October in a desperate bid to raise cash to cover immediate needs.

Only two of the regions, Madrid and La Rioja, currently meet the central government‘s conditions for issuing new debt in 2011. The other regions can only refinance existing debt.

The improved mood toward Spain, as a result of reforms and the improvement in some macroeconomic figures, is also filtering down to companies, which have been locked out of the funding market. Iberdrola and Telefónica issued last month the first bonds by Spanish non-financial companies since October. Both companies reported very strong order books for their issues as investors were drawn by the high premiums offered.

The Madrid stock market rallied strongly. It has risen 9.3% so far this year, after falling 17.4% in 2010 (see Figure 4).

Figure 4. Main Stock Market Indices (% change 1 January – 14 February)

Index	
Ibex-35 Spain)	**9.3**
Dax (Frankfurt)	7.0
FTSE 100 (London)	2.7
Euro Stoxx 50	8.0
Dow Jones	6.0
Nikkei (Tokyo)	4.8

Source: Markets.

Government Imposes Further Reforms on Savings Banks

Having reduced the number of unlisted savings banks from 45 to 17 under a restructuring ordered by the Bank of Spain, the government is now threatening to nationalise those *cajas*, as they are known, which do not reach a minimum level of capital adequacy –a core tier one ratio of 8% of risk-weighted assets– by September.

The *cajas*, regionally based and controlled to a significant extent by local politicians, have become a headache for the government –unlike the much healthier listed commercial banks– because they need billions of euros in fresh capital and in a worstcase scenario raise the spectre of an Irish-style bail-out. The weakness of smaller and medium-sized *cajas,* which are heavily exposed to a property sector whose bubble burst in 2008, is one of the factors that has sapped international confidence in Spain.

The Bank of Spain has demanded greater transparency in banks' exposure to the real estate sector. According to the figures published so far, savings banks have €98.3 billion of 'problematic' loans to this sector, 11.6% of their total lending in Spain excluding credits to public administrations, compared with €44.9 billion for commercial banks (7% of their total). These figures comprise bad and substandard loans and the value of foreclosed properties. Caja Madrid Bancaja, with €11 billion of foreclosed properties, has emerged as Spain's largest real estate holder. Santander, by comparison, has €8.3 billion of foreclosed properties even though it is a much larger bank.

The savings banks have already absorbed €15 billion in loans from the Fund for Orderly Bank Restructuring (Frob) and a deposit guarantee fund. According to Elena Salgado, the Finance Minister, they need up to €20 billion more capital. Furthermore, they are expected to raise it mostly from private sector investors who so far are showing little enthusiasm.

Independent estimates say €20 billion is not enough and put the cost of recapitalisation at between €45 and €120 billion. The time frame to reach a ratio of 8% is also regarded as too long.

The government's aim seems to be to force the poorly capitalised *cajas* to become listed banks.

The Financial Stability Board, the G-20 body responsible for supervising the financial sector, welcomed the government's moves but criticised the authorities for being slow to tackle the 'structural weakness' of the *cajas* and called for 'additional regulation efforts'.

La Caixa, the largest savings bank, was quick off the mark to announce that it will move its banking operations into a listed company in order to boost its capital base and keep on growing. The new bank would be about the 10th largest in the euro zone.

Caja Madrid, the other big savings bank, and six smaller *cajas* will pool their retail banking businesses in a new joint company that will be Spain's biggest domestic retail bank. The group, called Banco Financiero y de Ahorros (BFA), headed by Rodrigo Rato, a former Finance Minister and Managing Director of the International Monetary Fund (IMF), would also list on the stock market.

Overall Jobless Rate Tops 20%, Youth Unemployment Surpasses 40%
The Spanish economy is slowly emerging from recession (annualised growth was 0.2% in the fourth quarter of 2010), but almost one-third of the total 15.7 million unemployed people in the euro zone live in Spain.

The jobless rate at the end of 2010 was 20.3% (4.7 million people), the highest level in 13 years and double the average of the 16 euro countries (see Figure 5), and the rate for those under the age of 25 was 42.8%.

Figure 5. Euro Area Unemployment Rates, Selected Countries

Country	Unemployment Rate
Spain	**20.3**
Greece	12.9
Portugal	10.9
Euro zone	10.0
Poland	10.0
France	9.7
Italy	8.6
UK (1)	7.8
Germany	6.6
Netherlands	4.3

(1) October.
Source: Eurostat.

While the economy is beginning to pick up, the unemployment rate has continued to rise, although at a much slower pace than in 2008 and 2009. Around 1,000 people a day lost their job in 2010.

Particularly worrying is the very high level of youth unemployment. Dominique Strauss-Kahn, the Managing Director of the IMF, warned of the social risks emanating from what he called a 'lost generation'. The level of youth unemployment is now more than double what it was in 2006 when the economy was booming.

The labour force survey for the fourth quarter showed that 1.32 million households had no occupants in employment, up from 512,500 at the beginning of 2008.

The unemployment rates in Spain's 17 regions vary considerably, from 28.3% in Andalusia, the highest, to 10.9% in the Basque Country, the lowest.

The largest number of jobs lost during the fourth quarter compared to a year earlier was in construction. The loss of a further 230,200 jobs brought the total number of unemployed in this sector to 1.57 million. The number of long-term unemployed (more than a year) surpassed 2 million for the first time.

The government is working on policies that more actively seek to get the unemployed back to work rather than just offering unemployment benefits.

A new programme for the unemployed whose benefits had run out came into force on 16 February. Among the conditions for receiving €400 a month is to attend a training course. At the end of 2010, only 865,000 of the 4.7 million unemployed were in courses.

Spain's Spending on R&D+i Inches Up

Spain's spending on research and development and innovation (R&D+i) increased to 1.38% of GDP in 2009 from 1.35%, according to the latest comparative figures (see Figure 6).

Figure 6. Spending on R&D+I (% of GDP), 2009

Country	% of GDP
Finland	3.96
Germany	2.82
EU-27	2.01
UK	1.87
Spain	**1.38**
Portugal	1.66
Italy	1.27

Source: Eurostat.

China Steps up is Presence in Spain

China Unicom, the country's second-largest telecoms operator, is to have a seat on the board of Telefónica, Spain's telecoms conglomerate, and the Industrial and Commercial Bank of China (ICBC), the world's biggest lender by market value, opened its first branch in Madrid as part of an expansion in Europe.

The two moves came hard on the heels of the visit in January to Madrid of Li Keqiang, China's Deputy Premier.

China Unicom and Telefónica agreed to deepen their strategic co-operation agreement through a further mutual purchase of each other's shares for US$500 million. This will increase Telefónica's stake in China Unicom to 9.7% and China Unicom's in Telefónica to 1.37%.

China Unicom became the first mainland Chinese group to have a stake in a European telecoms operator when it arranged with Telefónica mutual share-buying worth US$1 billion each in September 2009.

ICBC already has a significant Chinese community in Spain with which to do business. Officially, there are around 170,000 Chinese in the country, but the real number including illegal immigrants is estimated at around 240,000. The Chinese have established a significant presence in clothes, shoes and toys.

China runs a hefty trade surplus with Spain. In 2009, Spain imported €14.5 billion of products from China, making it the third-largest supplier after Germany and France, and exported only US$2 billion of its own goods to China.

China's share of Spain's total foreign trade almost doubled between 1992 and August 2010 (see Figure 7).

Figure 7. China's Share of Each Country's Total Foreign Trade (% of total exports and imports)

	1992	12monthstoAugust2010
France	1.0	3.8
Germany	1.3	6.1
Italy	1.2	4.8
Spain	**1.2**	**4.2**
UK	0.6	6.2

Source: IMF and Haver Analytics.

Iberdrola to Buy Brazil's Elektro

Iberdrola, Spain's main power utility, agreed to acquire Brazil's Elektro from Ashmore Energy International for €2.4 billion in cash, in a further expansion into emerging markets.

The purchase will make Iberdrola one of the leading operators in Brazil's electricity sector, where it already owns 39% of the distribution and generation company Neoenergia alongside Banco do Brasil. Elektro serves 2.2 million clients in São Paulo state.

Iberdrola has embarked on a strategy of further international expansion, particularly in markets with potential such as those of the US, Mexico and Brazil. Around two-thirds of Iberdrola's profit in 2010 came from outside Spain.

Santander and BBVA Boost Profits in their Foreign Operations

The foreign operations of Santander, the euro zone's largest bank by market value, and BBVA, the other big commercial bank in Spain, continued in 2010 to generate a larger share of their profits, helping to offset the sharp downturn in their home market.

Santander's net profit fell 8.5% to €8.18 billion, largely because of provisions and write-offs for bad loans in Spain following the bursting of the property bubble three years ago. But for charging €472 million of provisions to its third quarter results, Santander's profit would have been similar to that in 2009.

BBVA's net profit was 9.4% higher at €4.61 billion, as it took an extraordinary charge in 2009 for provisions and write-offs and so was less affected in 2010.

Santander's bad loans as a share of total lending rose from 3.24% in 2009 to 3.55% in 2010, while in Spain the ratio increased from 3.41% to 4.24%. BBVA's ratio dropped from 4.3% to 4.1%.

In both banks, Latin American results offset lower profits in Spain. The net profits of Santander in Spain plummeted 33.9% to €2.50 billion, but profits generated in Brazil increased 31% to €2.83 billion. BBVA's net profits in Spain and Portugal fell by 9% to €2.07 billion, but this was offset by an almost 12% jump in net profits in Mexico to €1.71 billion.

Latin America accounted for 43% of Santander's profits, with Brazil alone generating a quarter (see Figure 8), while 48.4% of BBVA's came from Latin America and the US (see Figure 9).

Figure 8. Geographic Distribution of Santander's Attributable Profit (% of total operating areas)

	2004	2010 (1)
Continental Europe	59	35
Santander branch network	25	11.2
Banesto	11	3.8
Santander Consumer Finance	9	7.3
Portugal	7	4
Latin America	41	43
Brazil	16	25
Mexico	9	6
Chile	6	6
UK	–	18
US (Sovereign)	–	4

(1) First six months.
Source: Santander.

Figure 9. Geographic Distribution of BBVA's Attributable Profit (% of total) (1)

	2004	2010
Spain & Portugal	50.3	35.4
Global businesses	12.0	16.2
Mexico and US	30.0	33.2
South America	7.7	15.2

(1) Figures rounded up and the calculations made without including the losses in corporate activities.
Source: BBVA.

Santander plans to float its UK subsidiary in the second half of 2011. This unit contributed a greater share of profits in 2010 than Spain. In Poland, it launched a €4.2 billion bid to buy all of Bank Zachodni WBK, in which it agreed last year to acquire a 70% stake from Allied Irish Banks.

BBVA plans to take advantage of the restructuring among Spain's unlisted savings banks (their number is being reduced from 45 to 17) to increase its share by half in its domestic market. Its share is down to around 11% from 16% at the time of the BBV-Argentaria merger a decade ago.

Corporate Exposure to Egyptian Upheaval Low

Spain's economic interests are barely affected by the popular uprising in Egypt, which forced Hosni Mubarak, the country's President, to step down after 30 years in power. Few Spanish companies operate in the country (see Figure 10).

Figure 10. Spanish Companies in Egypt

Company	Activity
Gas Natural Fenosa	Liquefied natural gas plant
Cepsa	Oil exploration with partners
Iberdrola Ingeniería	Construction of power plants
FCC	Water purification
Gamesa	Wind turbines for local companies
Cementos La Unión	Arabian Cement Company
Inditex	14 clothing shops
Sol Meliá	Four hotels
Barceló	One hotel
Partner Hotels	Five hotels

Source: *El País*, based on Spain's commercial office in El Cairo.

The volume of trade is also low, and in Egypt's favour. Spain's exports to Egypt in 2009 amounted to €831.7 million and its imports from Egypt €1.43 billion.