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William Chislett

Foreign Policy

Zapatero, First Foreign Leader to Visit the New Government in Tunisia

Prime Minister José Luis Rodríguez Zapatero made the first visit of a foreign leader to Tunisia following the overthrow of Zine el-Abidine Ben Ali by a popular uprising in January.

'We have not come to say how Tunisian citizens must do things, we have come to tell them that we are at their service', he said on 2 March after talks with interim President Foued Mebazaa and new interim Prime Minister Beji Caid Essebsi.

Rodríguez Zapatero said Spain would make €300 million in loans through the European Investment Bank to help spur an economic recovery in Tunisia. He mooted the idea of an economic development plan for the Magreb along the lines of the US's Marshall Plan after the Second World War.

Spain joined France and the UK in organising an air bridge to move thousands of foreign workers stranded on the Tunisian side of the border with Libya after fleeing the crumbling regime of Colonel Muammer Gaddafi. Most of the workers were Egyptian. Spain also delivered 30 tonnes of humanitarian aid and Pablo Yuste, the head of the Spanish Agency of International Co-operation, met with members of the rebels' National Liberation Council, led by Mustafá Abdel Jalil, the former Justice Minister, in Benghazi.

Zapatero said a military intervention in Libya should be the 'last resort' and that Spain would only participate in it if three conditions were met: approval of it by the UN Security Council; agreement by the European Council and, if necessary, the green light from Spain's parliament.

Spain has few commercial interests in Libya. The main companies there are Repsol (oil) and Sacyr (construction). Repsol stopped producing oil shortly after the uprising began. Spain's imports from Libya in 2010, almost entirely oil, amounted to €3.3 billion and its exports to the country were €259 million.

Zapatero also visited the wealthy Gulf states of Qatar and the United Arab Emirates (UAE), which have escaped the wave of revolts and where he sought to drum up business and investment in the Spanish economy. The authorities in Qatar said they would invest €3,000 million in Spain, €300 million of it in capitalising ailing savings banks. The UAE will also invest in savings banks (€150 million).

Qatar Holding, a sovereign wealth fund, announced after Rodríguez Zapatero's visit that it would acquire a 6.16% stake in Iberdrola, Spain's largest power utility, for €2 billion. The deal is part of a strategic partnership involving the opening by Iberdrola of a new regional office in the Gulf.

Before his visit, the International Petroleum Investment Co (Ipic), an Abu Dhabi sovereign wealth fund managed by members of the country's royal family, announced it fully owned Cepsa, Spain's second-largest oil company, after acquiring the 49% stake of France's Total and 4% in other hands.

Ipic, which first entered Cepsa in 1988, agreed to pay €3.7 billion for Total's stake. It owned 47% of Cepsa, having bought the 32.5% stake of Santander, Spain's biggest bank, two years ago.

Cepsa refines and distributes fuel in Spain and Portugal and also has exploration and production interests in Latin America and North Africa.

The uprisings in Tunisia and Egypt are fuelling the arrival of more illegal immigrants from North Africa in Europe, particularly in Italy. Spain, the Arab world's nearest neighbour in the EU, has escaped an influx so far, but would not do so if the wave of revolts reached Morocco, the origin of more than 700,000 of Spain's immigrants.

'Of course things are different in Morocco. It's a country that has undertaken reforms', was Rodríguez Zapatero's verdict when asked about the possibility of change in that country ruled by an autocratic monarchy.

At the request of Rodríguez Zapatero and Nicolas Sarkozy, France's President, the final communiqué issued at the end of the EU's summit in Brussels on 11 March included a reference welcoming the recently announced reforms of King Mohammed VI to limit his powers.

Spanish Parliamentary Committee Rejects Recognition of Armenian Genocide
The foreign affairs committee of the parliament rejected a proposal put forward by a radical Catalan party to recognise the 1915 Armenian genocide attributed to Turkey.

The ruling Socialists, the conservative Popular Party (PP), the main opposition, and the nationalist Convergence and Union (CiU) party, which governs Catalonia, voted against the motion presented on 9 March by the Republican Left of Catalonia (ERC). The Basque Nationalist Party (PNV) voted in favour.

This was the first time the genocide issue was discussed in an organ of the parliament. Turkey rejects the term.

Both the Socialists and the PP actively support Turkey's full EU membership, which the country has been negotiating since 2005. It is one of the few foreign policy issues on which both parties agree.

Turkey is one of the seven countries with whom Spain has an annual summit and the UN-backed Alliance of Civilizations initiative to defuse tensions between the West and Islam was jointly launched by José Luis Rodríguez Zapatero, Spain's Prime Minister, and his Turkish counterpart Recep Tayyip Erdogan in 2005. Had the motion been approved, it would have endangered the close relations between the two governments. The parliaments of more than 20 countries have recognised the Armenian genocide. Armenia opened its first embassy in Madrid last year.

Domestic Scene

Government Refers Legalisation of new Basque Party to the Supreme Court
Sortu, the new version of Batasuna outlawed in 2003 for its ties to the Basque terrorist group ETA, is only 'a mere attempt to appear to be complying with the law', according to the State Attorney General, Cándido Conde-Pumpido, who said the government would contest its legalisation before the Supreme Court.

'It is not a political party', he added, but an attempt to 'desperately maintain ETA's presence on a political horizon which it now knows it has no chance of entering'.

Sortu presented its statutes last month when its leader, Rufi Etxeberría, 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 party, however, did not condemn ETA's past violence, which has resulted in the killing of more than 820 people in 42 years, most of them since the end of the Franco dictatorship in 1975 and the return to democracy under the 1978 constitution and a large degree of self-government in the Basque Country.

Sortu wants to take part in May's local elections in the Basque Country. Thousands of people staged a march in the Basque city of Bilbao last month calling for Sortu's legalisation.

José Antonio Ardanza, the Basque Nationalist Party premier of the Basque Country between 1985 and 1998 accused the government of 'cowardice' for remitting the 'hot potato' regarding the decision on Sortu to the Supreme Court. He said it was the government's responsibility to decide whether the party's statutes met the requirements of the law on political parties.

The government says the party's legalisation should be decided by the Supreme Court as it was the body that proscribed Batasuna.

Ramón Jáuregui, the Socialist Minister of the Presidency and a former Deputy Premier of the Basque Country, said the only way for Sortu to participate in democratic institutional life was for ETA to be disbanded.

The Economy

Government Approves Law on New Bank Capital Rules, Moody's Downgrades Spain's Credit
The new law which requires banks to strengthen their capital by September or run the risk of partial nationalisation gives the unlisted savings banks or *cajas*, the weakest part of Spain's financial system and the one making international markets nervous, until March 2012 to organise stock market flotations.

The tighter rules, brought on by the burden of bad property loans (heavy in the case of some *cajas*), require banks to have a core tier one capital ratio of 8% of risk-weighted assets and 10% for those that are very reliant on wholesale markets for their funding and lack shareholders holding at least one-fifth of their capital.

The average capital ratio of banks in Spain is at the lower end of Europe (see Figure 1).

Figure 1. Average Core Tier One Capital Ratios, 2011 (%)

	%
Switzerland	15.7
Nordics	12.0
UK	10.9
France	9.6
Benelux	8.5
Italy	8.4
Spain	**8.1**
Germany	8.1
Austria	4.1

Source: Morgan Stanley; Financial Times research. Latest figures.

The *cajas* began as regionally-based institutions and since 1989, when restrictions were removed on expanding outside their home areas, they have spread all around Spain. Between 2000 and 2010 the number of their branches rose from 19,268 to 23,743, while those of commercial banks dropped from 15,811 to 14,670 (see Figure 2). Apart from the structure of their capital and their governing bodies, which are dependent on the political make up of each region, the *cajas* are essentially the same as commercial banks. At the end of 2010, the *cajas* had €622 billion of deposits and the commercial banks €489 billion.

'They have grown excessively', said Fernando Fernández, director of the Chair of International Financial Regulation at Madrid's IE Business School and the author of a report on the *cajas* for FAES, the think-tank of the conservative Popular Party. 'Today, they have made Spain an exception and created a differential problem and an asymmetric risk for the Spanish economy'.

Figure 2. Branches and Employees of Savings and Commercial Banks, 2000-10

	2000	2003	2005	2007	2010
Branches					
Savings banks	19,268	20,871	22,410	24,591	23,743
Commercial banks	15,811	14,074	14,533	15,542	14,670
Employees					
Savings banks	101,718	110,243	118,072	131,933	132,340(1)
Commercial banks	122,374	111,793	111,298	117,559	110,004(1)

(1) 2009.
Source: Bank of Spain

The *cajas* have a proportionately much larger share of their total lending in mortgages than the commercial banks (see Figure 3). The property sector bubble burst in 2008 and there is still a glut of unsold homes. Some savings banks have become significant holders of real estate as a result of foreclosures and acquiring the properties of indebted customers.

Figure 3. Mortgages as a Percentage of Total Lending

	2000	2003	2005	2007	2010
Savings banks	32.6	40.9	47.5	49.5	44.7
Commercial banks	15.6	20.3	23.2	23.5	23.7

Source: Fernando Fernández, based on figures of the banks.

Under pressure from the Bank of Spain, the number of *cajas* has been reduced from 46 to 17. The two largest ones, La Caixa, based in Barcelona, and Caja Madrid, based in the capital of Spain, have announced flotation plans.

Banco Financiero y de Ahorros (BFA), the result of the merger of Caja Madrid, Bancaja and five other *cajas*, is to set up a 'bad bank' containing its non-performing property assets in order to enhance the attractiveness of its flotation.

The Bank of Spain says the savings banks' loans to the real estate sector amount to €217,000 million, of which 46% are 'potentially problematic' to varying degrees and are 38% covered by provisions.

Moody's much higher estimate of the capital needs of Spanish banks than that of the Bank of Spain and its concerns over the lack of fiscal discipline in regional governments (see item below) led it on 10 March to downgrade Spain's sovereign credit rating by one notch to Aa2. The rating agency said the banks would require between €40 billion and €120 billion in extra capital. Spain held triple A ratings from all the main rating agencies before the global financial crisis.

The Bank of Spain very quickly responded to Moody's and said the entire system required only a further €15.5 billion, 93% of it for savings banks.

Spain's 10-year bond yield was 5.29% on 14 March when the risk premium over German benchmark bonds, which denotes the degree of international confidence, was 2.05 pp (see Figure 4). This was lower than a month earlier and still far from neighbouring Portugal whose 10-year bond yield was 7.6% (where Ireland's was when its international bail-out was triggered last November) and its premium 4.37 pp.

Figure 4. 10-year Government Bond Spreads Over Bunds (pp)

	November 16	December 14	January 14	February 14	March 14
Greece	+9.11	8.84	+8.27	+8.25	+9.17
Ireland	+5.82	5.45	+5.49	+5.90	+6.28
Italy	+1.59	1.62	+1.65	+1.53	+1.55
Portugal	+4.21	3.51	+3.84	+4.28	+4.37
Spain	**+2.00**	**2.54**	**+2.31**	**+2.17**	**+2.05**

Source: ThomsonReuters.

Motorway Speed Limit Cut in Bid to Reduce Soaring Energy Bill

The speed limit on motorways was reduced as of 7 March from 120km per hour to 110km in a move aimed at saving petrol, following the sharp rise in crude oil prices as a result of the uprising in Libya. It is the main element in a battery of 20 energy-saving measures.

Alfredo Pérez Rubalcaba, the Deputy Prime Minister, said the measure would be reviewed in July and would reduce consumption of petrol by about 15% and of diesel by 11% in a country where every US$10 rise in oil prices costs an extra €6 billion a year. This figure is the equivalent of the government's annual budget for R&D.

'There is no risk to supply of oil and gas in the country', he said, 'but we have found ourselves obliged to take some measures to save energy and lighten the energy bill as a result of the crisis in north Africa'.

Libya supplied around 13% of Spain's imported oil in 2010 and 1.6% of its gas. Repsol, the Spanish oil company, was one of those forced to shut down production in Libya at the end of February.

The bill for Spain's imported oil in 2010 was €25.5 billion, €10.5 billion more than in 2009. The average cost of filling up a car with petrol has risen by between €11 and €14 in the last year.

Spain's motorway speed is now among the lowest in the EU along with Denmark and Poland. The move has various precedents resulting from the 1970s oil crisis. The US reduced its speed limit on freeways to 55 miles per hour and Britain imposed a maximum speed of 50mph.

In order to encourage people to use public transport more, the price of commuter and short-distance rail tickets was cut by 5%. The Madrid and Catalan regional governments, respectively controlled by the conservative Popular Party and the conservative nationalist CiU, objected to the measure, which they said they could not afford. Regional governments are responsible for the cost of public transport and their deficits as a whole overshot the central government's target last year.

Higher petrol prices were a major factor behind Spain's annual inflation rate reaching a two-year high of 3.6% in February, up from 3.0% in January and double the rate of six months earlier. With the economy beginning to grow a little (-0.1% in 2010 and a forecast of less than +1% this year), the recovery is in a delicate stage.

Budget Deficit Target Met Despite Overshoots by Most Regional Governments
Spain met its budget deficit target for 2010 even though 13 of the 17 regional governments failed to meet their target as part of the austerity measures to calm the international bond markets.

The overall deficit came in at 9.24% of GDP, just below the objective of 9.3% and down from 11.1% in 2009. Only Madrid, Extremadura, the Basque Country and the Canary Islands met the 2.4% target for each regional government. The total deficit of regional governments was 2.83% of GDP.

The social security system registered its first deficit since 1998, due to the much higher cost of unemployment benefits (the jobless rate topped 20% in 2010) and the sharp drop in the number of contributors (see Figure 5).

Figure 5. Structure of the General Government Deficit (% of GDP)

	2010	2009
Central government	-5.66	-9.4
Regional governments	-2.83	-2.0
Local governments	-0.50	-0.50
Social security	-0.24	+0.8
General government	-9.24	-11.1

Source: Economy and Finance Ministry.

The overall budget deficit target for this year is 6.0% of GDP.

Profits of Main Listed Companies Improve

The total profits of the companies that comprise the Ibex-35 index, the main index of the Madrid stock market, increased by more than 20% in 2010 (see Figure 6).

Figure 6. Profits of the Ibex 35 Companies, 2010

Company	Sector	2010 net profits (€ mn, % change in brackets)
Abengoa	Energy	207.2 (+21.6)
Abertis	Infrastructure	661.6 (+6.1)
Acciona	Infrastructure	167.2 (-86.8)
Acerinox	Steel	122.7 (1)
ACS	Infrastructure	1,312.6 (-32.6)
Arcelor Mittal	Steel	2,202.0 (2,495.2)
Banco Popular	Banking	590.2 (-23.0)
Banco Sabadell	Banking	380.0 (-27.3)
Banco Santander	Banking	8,181.0 (-8.5)
Bankinter	Banking	150.7 (-40.8)
BBVA	Banking	4,406.0 (+9.4)
BME	Stock market	154.2 (+2.7)
Criteria	Investment	1,822.9 (+38.5)
Ebro Foods	Food	388.8 (+120.2)
Enagás	Gas	333.5 (+11.9)
Endesa	Electricity	4,129.0 (+20.4)
FCC	Infrastructure	301.3 (+1.8)
Ferrovial	Infrastructure	2,163.2 (1)
Gamesa	Wind turbines	50.2 (-56.2)
Gas Natural	Gas	1,201.0 (+0.5)
Grifols	Health care	115.5 (-21.9)
Iberdrola	Electricity	2,870.9 (+1.6)
Iber. Renovables	Renew. energy	360.0 (-3.0)
Indra	IT, defence	188.5 (-3.6)
Mapfre	Insurance	933.5 (+0.7)
OHL	Construction	195.6 (+25.3)
Red Eléctrica	Electricity	390.2 (+18.1)
Repsol	Oil	4,693.0 (+201.0)
Sacyr Vallehermosa	Construction	204.4 (-60.6)
Tecnicas Reunidas	Engineering	103.9 (-28.8)
Telecinco	TV	70.5 (+45.6)
Telefónica	Telcoms	10,167.4 (+30.8)

(1) Losses in 2009.

Source: Company data.

Nueva Rumasa to Suspend Payments by Some of its Companies

The Nueva Rumasa group, owned by the Ruiz-Mateos family and with interests in the food, drinks and hotel sectors, is to suspend payments by some of its companies in order to cope with its mounting debts.

The group was founded 22 years ago by José María Ruiz Mateos after his Rumasa conglomerate was expropriated by the Socialist government of Felipe González in 1983.

The unlisted group, which employs more than 3,000 people, has debts of more than €45 million with the social security system for unpaid company contributions and owes an unspecified sum to more than 5,000 investors who were attracted by securities paying 10% interest. The National Securities Market Commission warned investors seven times of the risk of investing in these securities.

The government's anti corruption unit is investigating Nueva Rumasa as is suspects the very high yield offered on its securities was used by some investors as a vehicle to launder black money.

Ruiz-Mateos said bank debts totalled around €700 million and suppliers were owed some €300 million. He blamed Banco Santander for the group's crisis and said he would sue the bank for cutting off credit.

Spain's House Prices among the most Overvalued in the World

Spain's property prices are 44% overvalued, the highest level among the big European economies, according to the latest survey published by *The Economist* (see Figure 7).

Figure 7. *The Economist* House-Price Indicators (% change)

	1997-2011	Under(-)/over(+)valued (1)
Hong Kong	-1	+53.7
Spain	**+157**	**+43.7**
France	+152	+48.0
UK	+178	+29.6
Italy	+93	+8.7
US (Case-Shiller national index)	+56	-7.7
Germany	NA	-12.2
Japan	-38	-35.2

(1) Against the long-run average of price-to-rents ratio.
Source: *The Economist*, based on its own and other sources.

Prices on average have not dropped substantially (-13% in nominal terms since the height of the property boom in 2008), despite an estimated stock of 700,000 empty properties seeking a buyer at the end of 2010 (2.8% of the total stock of homes). This figure is based on official sources. The research department of BBVA, Spain's second-largest bank, puts the figure at more than one million.

The number of housing starts has plummeted since the bursting of the property sector bubble and the much more restrictive financing conditions (see Figure 8).

Figure 8. Housing Starts, Under Construction and Completed

	Housing starts	Under construction	Completed
2005	716,200	1,056,000	445,239
2006	762,214	1,089,400	493,316
2007	611,136	1,067,100	554,619
2008	328,490	753,300	531,266
2009	159,283	392,000	320,362
2010 (estimate)	134,000	233,000	204,000
2011 (forecast)	144,000	212,000	125,000

Source: Afi and Development Ministry.

The number of property transactions (sales and purchases) in 2010 was 5.9% higher at 491,061, ending three years of declines and showing that the property market is beginning to move again.

More than Half of Employed Young Adults on Temporary Contracts

Not only was Spain's youth unemployment rate of 40% double the EU average in 2009, but 56% of those lucky enough to have a job (between the ages of 15 and 24) had temporary contracts, according to the latest comparative figures (see Figure 9). The jobless rate for this category currently stands at 43%.

Figure 9. Temporary Contracts of Workers Aged 15-24 (%) in EU Countries, 2009

Country	2009
Slovenia	66.6
Poland	62.0
Spain	**55.9**
Sweden	53.4
France	51.2
Italy	44.4
EU-15	41.5

Source: OECD.

More Billionaires in the Forbes Ranking

There are 15 Spaniards in the latest annual ranking of the world's billionaires by the US magazine *Forbes*, two more than in 2010 (see Figure 10).

The first-ranked Spaniard was again Amancio Ortega, the head of Inditex, the clothing manufacturer and retailer. He moved from 9th to 7th place, with a net worth of US$31 billion (US$6 billion more than last year).

Figure 10. Spanish Billionaires in the Forbes Ranking (1)

Ranking and name	Company/Sector	Net Worth (US$ bn)
7. Amancio Ortega	Inditex	31.0
159. Isak Andic	Mango	6.1
254. Rosalía Mera	Inditex	4.2
376. Manuel Jove	Investment	3.0
393 Juan Roig	Mercadona	2.9
512. Alicia Koplowitz	Investment	2.3
651. Esther Koplowitz	FCC	1.9
651. Florentino Pérez	ACS	1.9
736. José María Aristráin	Aristráin	1.7
833. Emilio Botín	Banco Santander	1.5
879. Gabriel Escarrer	Hotels	1.4
879. Enrique Banuelos	Real estate	1.4
938. Juan Abelló	Investment	1.3
993. Alberto Alcocer	Investment	1.2
993. Alberto Cortina	Investment	1.2

(1) Out of 1,210 people.
Source: Forbes.

Juan Roig, the owner of Mercadona (supermarket), entered the list for the first time and Gabriel Escarrer (hotels) returned to the list.

Spain, the EU Country where it Takes the Longest Time to Open a Business

Spain is still the EU country where it takes the most time (47 days) to obtain all the necessary permits for opening a business (see Figure 11), according to the latest edition of *Doing Business* published by the World Bank. The government has promised to reduce the red tape.

Figure 11. Number of Days Needed to Open a Business, Selected EU Countries

Country	2010	2006
Spain	**47**	**47**
Poland	32	31
Germany	15	24
UK	13	13
France	7	7
Italy	6	13
Belgium	4	27

Source: *Doing Business* 2011 and 2007, World Bank.