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Spain

SHOOTS VERDES: SPAIN EXPERIENCING A "GREEN SHOOTS" MOMENT

In April, Spain's risk premium dropped below 300 basis points for the first time since February 2012. The drop signaled increased investor confidence that the country was no longer at risk of a default. But is the country any closer to stabilization or even economic revival? Are there "green shoots" sprouting in this economy still suffering from 27 percent unemployment? We see evidence that suggests there are.

"Jobs, jobs, jobs."

TAKAWAYS

- Spain is experiencing deflation, which has brought prices in line with demand in both the labor and housing markets.
- Spain's labor costs, falling relative to those of other European Union (EU) countries, have spurred companies to invest in production there at the expense of other EU nations.
- The Spanish are adjusting their economic expectations to bring them more in line with their economic possibilities.
- European fatigue with austerity suggests Spain will not have to engage in steep cuts over the next two years that would undermine its economy. In particular, Germany appears poised to help Spain with loans and business support and perhaps to help other Southern European nations as well.

IMPLICATIONS

- Lower labor prices suggest Spanish manufacturing activity can increase.
- Spain will aggressively market itself in certain growth industries for which it can offer price advantages, such as medical tourism.
- Unemployment in Spain will drop, giving the Spanish economy a needed boost.

Spain's Labor Market Hits "Reset"

For a country in which unemployment currently tops 25 percent and youth unemployment tops 50 percent, jobs are currently a primary concern. And the labor market is adjusting. Unit labor costs in Spain fell 4 percent from 2008 through the first half of 2012, and 10 percentage points relative to the Eurozone. Under legislation currently being pushed by Prime Minister Mariano Rajoy, Spanish labor costs are likely to fall further, as it will be easier for companies to cut wages and reorganize staff.

More specifically, autoworkers' unions agreed in January to limit salary increases to 0.5 percent and 0.6 percent, respectively, this year and next. As a result, Ford is closing a plant in Belgium and shifting work to Valencia. VW is investing 785 million euro in a Pamplona plant to build Polos, and Renault is boosting output 30 percent over the next two years at its Valladolid and Palencia plants. Peugeot is also shifting work to the Iberian nation. (*Telegraph*, 5/15/13; *Bloomberg*, 12/19/13)

Some Spanish workers have agreed to keep manufacturing plants open seven days a week, without receiving Sunday overtime pay, and to accept wage increases that are below the rate of inflation. Also, managers for FCC, an infrastructure company, say that these days workers in Spain are willing to take on shifts 200 miles from their homes, something that workers in, say, Austria will not do. Another Spanish executive notes, "We have people who work in laboratories in the morning and as cleaners in the afternoon. . . . We would not find the same flexibility, say, in Germany." (*Telegraph*, 5/15/13; *Wall Street Journal*, 5/10/13)

These labor changes are already having an effect on the Spanish economy:

- Over the past year, exports from Spain to Africa have grown 15 percent, while those to Asia have increased 13 percent. Total exports climbed 5 percent, compared to a 3.2 percent fall in the UK. Total exports are at a record high. (*Telegraph*, 5/15/13)
- In January and February, Spanish overseas shipments of capital goods climbed 17.7 percent from the year-earlier period. (*El País*, 5/27/13)

And Help Is On the Way

European fatigue with austerity suggests Madrid will not have to make further deep cuts in government spending that would undermine Spain's economy. Last Wednesday (5/29), the European Commission (EC) backed away from mandating austerity, proposing to give Spain two additional years before the country has to bring its public deficit below the EU-mandated ceiling of 3 percent of GDP. Spain's 2012 deficit was 7 percent of GDP. The continued permission to run a bigger deficit would allow Madrid to help boost aggregate demand. (*El País*, 4/23/13; *Wall Street Journal*, 5/30/13)

Germany's willingness to offer support to Spain seems to be growing. Berlin's finance minister sent a letter to Berlin's economics minister, saying that Germany should offer European countries bilateral aid. The two German ministries are jointly responsible for the KfW, the government-owned development bank. Under the plan, the KfW could offer low-interest loans to a counterpart bank in Spain, which could pass on those lower rates to other Spanish banks and eventually to borrowers. At present, smaller firms in Spain have been forced to pay 250 basis points more for credit than rivals in other Eurozone nations, so the KfW program would alleviate a major disadvantage. The same two German ministers also announced a plan under which German companies would invest in small and medium-sized businesses in Spain. (*Spiegel*, 5/27/13; *Telegraph*, 5/15/13)

Additionally, Germany is playing a role in creating jobs for the Spanish people. Fifty thousand Spaniards found work in Germany last year, an increase of 15.8 percent from 2011. Germany may also be able to help Spain in other ways. Germany has agreed to create 5,000 jobs yearly for Spanish youth as part of a pact between Spain's and Germany's labor ministers. (*El País*, 5/21/13, 4/29/13 and 1/4/13)

Stabilizing Spanish Real Estate

Government entities in Spain are also trying to stabilize the real-estate market, the sector of the economy that contributed most to Spain's boom and bust. The regions of Andalusia and Catalonia have announced plans to fine or tax banks that hold empty houses. Andalusia has gone further, approving a moratorium of up to three years, during which banks may not evict the occupants of foreclosed homes, effectively keeping such homes off the market. To help support demand, Spain is offering residency to foreigners who buy 500,000 euros worth of Spanish real estate, mimicking a program called the Entrepreneurial Law, which offers residency to foreigners who buy 2 million euros worth of Spanish public debt. (*El País*, 4/23/13)

A Strong Signal

Spain's economics minister announced that Spain would not take any more than the $40 billion it had already taken from a $100 billion loan offering made by Germany to recapitalize its banks. Spain used the $40 billion to recapitalize three banks that had been overexposed to the real-estate sector, and also to capitalize Sareb, a "bad bank" that acquired a large portfolio of properties. Investors, including Deutsche Bank and Barclays, agreed to buy 55 percent of the capital in Sareb, which will soon begin real-estate sales. Subsequently, the economy minister announced that Spain no longer had trouble getting any additional funds it would need from the capital markets. (*El País*, 5/16/13; *Bloomberg*, 5/22/13)

The Next Growth Markets

Meanwhile, Spanish enterprises are positioning their country as a low-cost destination for medical tourism. Various surgeries in Spain cost 30 to 70 percent less than they do elsewhere in Europe, with cosmetic surgery procedures costing on average 60 percent less than in the UK. Spain already leads Europe in organ transplants. Meanwhile, over the last two decades, Barcelona has become the top destination for Europeans, as well as many Russians, Middle Easterners and North Africans, seeking fertility treatments. Fertility clinics are reporting "no shortage" of egg donors among Spanish women, perhaps due to the country's high unemployment rate. (*El País*, 3/18/13; *Spiegel*, 5/9/13)

The changes in Spain's structural economy over the past several months include:

- A reset in Spain's labor rates and practices, providing a competitive advantage for Spanish companies.
- Help from Germany in recognition that a stronger Spain means a stronger EU.
- Less stringent austerity requirements by the EC, which allows for reasonable government spending geared to stimulating the economy.
- Downward adjustment of living standards, reflecting lower income and expenses.
- Foreign companies' investment in manufacturing facilities in Spain, taking advantage of lower costs.
- The recovery of exports, due to competitive pricing.
- Measures offered by the Spanish government (entrepreneurial law), to encourage foreign investments.