

Inside Spain 88 (17 September-22 October)

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Foreign Policy

Spain Seeks UN Security Council Presence

Mariano Rajoy, the Prime Minister, decided to maintain the previous Socialist government's bid to become a non-permanent member of the UN Security Council in 2015-16.

The last time Spain was a member was in 2003-04, during the conservative government of José María Aznar (1996-2004). The Popular Party returned to power last November when it trounced the Socialists.

Spain is competing for one of the two seats with Turkey and New Zealand. The 193 UN members will vote on the issue in October 2014. Given Spain's long and deep recession, the government said its campaign to win a seat would be austere and cost less than US\$2 million.

The decision means that Rajoy will have to be more disposed towards the 'Alliance of Civilisations' initiative, one of the pet international schemes of José Luis Rodríguez Zapatero, the previous Socialist Prime Minister, which he launched together with Turkey's Prime Minister, Recep Tayyip Erdoğan, in 2005 as a way to cross cultural and religious divides between communities.

The PP showed little enthusiasm for the Alliance as it viewed its creation as a way to compensate for Aznar's enthusiastic support for President George W Bush's 'global war on terror'.

In 2004 Rodríguez Zapatero withdrew the 1,500 peacekeeping troops from Iraq that Aznar had sent. To pull out of the Alliance would probably dash the PP's hopes of winning a UN seat and leave the way clear for Turkey.

Spain's contribution to the Alliance, which the UN has adopted as its own, has been greatly reduced because of budget cuts.

Domestic Scene

Madrid and Barcelona on Collision Course over Catalan Independence Referendum

The regional Catalan government defied the central government by saying it would call a referendum on independence, which Madrid says is illegal, and hold snap elections on 25 November.

Artur Mas, the Catalan premier, met Prime Minister Mariano Rajoy and failed to win support for a referendum or for fiscal autonomy (along the lines of the Basque Country and Navarre, which both enjoy a high level of the latter).

Catalan nationalists say their economic situation suffers unfairly from having to transfer to Madrid a disproportionate share of wealth in relation to the funding it receives under the quasi-federal system developed after the end of the Franco dictatorship in 1975. But for this arrangement, Catalonia, whose economy is the size of Portugal's, would not have had to make such deep cuts to its social spending, according to Mas.

Catalonia has asked for a handout of €5.4 billion from a central government fund to help it pay its debts as it is locked out of the markets.

Supporters of independence, for which there was a massive clamour at a demonstration last month in Barcelona, have drawn comfort from the deal earlier this month between David Cameron, the British Prime Minister, and Alex Salmond, the First Minister of Scotland, for a referendum on Scottish independence by the end of 2014. The two sides also agreed on the question to be put.

Mas challenged Rajoy to emulate this arrangement and said that if he did not he would internationalise the conflict. The Catalan parliament has already backed the calling of a referendum.

Alberto Ruiz-Gallardón, the Justice Minister, said the government would ask the Constitutional Court to suspend the referendum if it was called and if it still went ahead Mas would be accused of 'disobedience' under the penal code and face a disqualification in a public post for up to three years.

José Manuel Lara, the chairman of the Barcelona-based Planeta publishing group, Spain's largest, said he would relocate the corporate headquarters if Catalonia became an independent state.

The Roman Catholic Church also entered the fray. The hierarchy in Catalonia said it would be 'on the side of the Catalan people' if the region became a state, putting it at odds with the hierarchy in Madrid, which defends the unity of Spain.

Were Catalonia to become independent, it would not automatically remain part of the EU, as the relevant treaties make no allowance for this. It would have to apply for membership.

Mas is hoping to win a larger absolute majority in the Catalan elections (two years ahead of schedule), which would give him a free hand in the region to press ahead with a referendum.

In a separate development, Catalan nationalist passion was further inflamed by a call from José Ignacio Wert, the Education Minister, to 'Hispanicise' Catalonia. Wert said a lack of emphasis on the Spanish language and history in Catalan schools had contributed to the intensified move for independence.

Catalan, whose use was restricted under the Franco dictatorship, is the dominant language in the region.

Police Arrest More than 80 People in Swoop on Chinese Mafia

Police detained more than 80 people, mainly Chinese, in a crackdown on criminal gangs involved in tax evasion and laundering €1.2 billion over the last four years.

Officers seized around €10 million in cash in raids across the country on more than 100 premises, as well as some 200 vehicles, guns, jewels and works of art. More than €1 million was found floating in the petrol tank of a car.

The epicentre of the operation is the huge Cobo Calleja trading estate at Fuenlabrada on the outskirts of Madrid, which is said to be Europe's biggest Chinese wholesale hub.

A Socialist councillor responsible for security at Fuenlabrada, a police inspector and a Civil Guard sergeant were also arrested.

The network set up to move large amounts of money to China by people hired for purpose was also used to repatriate money that Spanish businessmen had illegally taken out of the country during Spain's economic boom and placed in tax havens.

PP Holds on to Galicia, Nationalists Return to Power in the Basque Country

The Popular Party (PP) held onto Galicia and won more seats in the regional election, a poll viewed to some extent as a referendum on the PP's unpopular economic programme at the national level.

The PP won 41 of the 75 seats, up from 38 in 2009, though with 135,000 fewer votes. Galicia, from where Prime Minister Mariano Rajoy hails, has long been the party's fiefdom. The victory is a shot in the arm for the embattled Rajoy.

In the Basque Country, the centre-right Basque Nationalist Party (PNV) returned to power with 27 of the 75 seats in the region's parliament. This was three fewer than in 2009 but 11 more than the Socialists, who gained the most seats in the last election.

Bildu, the pro-independence party previously banned from running by the Constitutional Court, was the second-largest party with 21 seats. It is expected to support the minority PNV government directly or indirectly.

Socialist support plummeted in both Galicia and the Basque Country. The party, trounced by the PP in the general election last November, lost seven seats in Galicia (from 25 to 18) and nine in the Basque Country (from 25 to 16). It obtained 230,817 fewer votes in Galicia and 106,173 fewer in the Basque Country.

The greatly increased share of the vote won by nationalists and separatists in the Basque Country (59.6% of the total votes cast compared with 48.3% in 2009), coming on top of the push for independence in Catalonia, will exacerbate the issue of holding Spain together.

Politicians Viewed as the Third Most Serious Problem

One in every four Spaniards views the political class as the country's third most serious problem after unemployment and other economic problems, the highest level ever (see Figure 1), according to a survey by the government-funded Centre for Sociological

Figure 1. What are Spain's main problems?

	% of respondents
Unemployment	79.3
Other economic problems	49.4
The political class	26.9
Healthcare	9.1
Corruption and fraud	8.5

Source: CIS.

Another poll (by Metroscopia) showed that 90% of respondents thought the political class had abandoned the spirit of consensus that existed during the transition to democracy and had become a self-serving caste that put its own interests before those of the nation.

Spaniards blame politicians for creating the property bubble, the bursting of which has produced massive unemployment, the collapse of banks and many corruption scandals.

Several thousand people demonstrated outside parliament in Madrid in the last week of September. Police fired rubber bullets and baton-charged protestors.

Soraya Sáenz de Santamaría, the Deputy Prime Minister, responded to the discontent by commissioning the Centre of Political and Constitutional Studies to prepare a report on how to regenerate Spain's democracy.

A court rejected the case against the organisers of the protests brought by the police. The magistrate, Santiago Pedraz, angered politicians when he declared in his edict that the protest was justified by the 'generally recognised decadence of the political class'.

Support for the ruling Popular Party since it returned to power last November has fallen considerably, but the Socialists have not advanced.

If there were elections now, the PP would gain 29.9% of the vote, down from 44.6% last November when it won the election, and the Socialists 23.9% (from 28.7% last November), according to a poll by Metroscopia earlier this month.

Eighty four per cent of respondents said they had little or no confidence in Mariano Rajoy, the Prime Minister, and 90% said the same about Alfredo Pérez Rubalcaba, the Socialist leader.

A damning analysis of the political class in *El País*, the main daily, by César Molinas, a former investment banker at Merrill Lynch, who called the class an 'extractive elite', became the main topic of the chattering classes.¹ He pressed the need for political reform, including getting rid of the system of closed, blocked electoral lists of candidates drawn up by the party leadership.

¹ http://elpais.com/elpais/2012/09/12/inenglish/1347449744_053124.html.

The candidates positioned highest on a closed list tend to always get a seat in the parliament while the candidates positioned very low do not. Voters have no influence on the party-supplied order.

A Metroscopia poll showed 85% support for a system of open lists, which would enable voters to change the order of candidates, and 82% support for an electoral system that better matched the number of votes with the number of seats gained in parliament.

The d'Hondt system used in Spain tends to give a disproportionate number of seats to regional parties, such as the Catalan CiU, and an undue influence over the formation of a national government when the winning party does not have a majority of seats in parliament.

Surge in Emigration of Spaniards

Spaniards and not just foreigners are increasingly leaving Spain. Close to 55,000 Spaniards emigrated in the first nine months of this year, 21.6% more than in the same period of 2011. The total number who left the country was 420,150 (+9.8%).

Since January 2011, 927,890 foreigners, mainly from non-EU countries, and 117,523 Spaniards have voted with their feet, largely in search of a better life. Spain's jobless rate is 25% and more than 30% for immigrants.

As a result, Spain's population is beginning to decline after relentlessly rising.

While the pace of emigration has quickened, that of immigration has slowed. A total of 282,520 people arrived in the first nine months of 2012 (29,373 of them Spaniards), down from 345,890 in the same period of 2011.

In the first nine months, net migration (the difference between the number of emigrants and immigrants) was 137,630, compared with 36,720 in 2011.

New Coastal Law Delays Demolition of Homes for 75 years

Homes built on public coastal land within 100 metres of the sea which were due to be demolished as of 2018, under a 1998 law, have been given a further 75 years of life.

An estimated 10,000 homes were built on public land, mostly before the 1998 Coastal Law, and some of them are owned by foreigners.

The government said the new law 'will better protect the coast from urban planning excesses, generate more economic activity and be an effective tool to protect the coast, ensuring security for citizens and businesses'.

In addition, 23,000 non-residential buildings, many of which are bars and restaurants, will also be saved.

Much of Spain's coastline, particularly the Costa del Sol, has been ravaged over the last 20 years by unchecked building.

The Economy

Bailout in Abeyance

‘The rescue is coming!’, but only according to posters in Madrid streets advertising a sketch comedy providing light relief from the country’s long-running bailout saga. The government has still not made up its mind.

The ECB’s much-awaited announcement last month of ‘unlimited’ purchases of sovereign bonds raised the possibility that Prime Minister Mariano Rajoy would request a bailout.

This ‘bazooka’ lowered Spain’s 10-year borrowing costs and they continued to decline this month to their lowest level in half a year after Moody’s decided not to reduce the country’s credit rating to ‘junk’ status. The 10-year government bond yield was 5.54% on 22 September, down from a peak of 7.51% in July (see Figure 2).

Figure 2. 10-Year Government Bond Yields (%) and Spreads over Germany’s Bunds

	Yield (%) and Spread (pp) (1)	Yield (%) and Spread (pp) (2)
Germany	1.62	1.68
Greece	16.49 (+14.87)	20.85 (+19.1)
Italy	4.77 (+3.15)	5.18 (+3.5)
Portugal	7.67 (+6.04)	8.32 (+6.6)
Spain	5.54 (+3.92)	6.03 (+4.3)

(1) 22 October.

(2) 17 September.

Source: ThomsonReuters.

This played into the hands of those who believe Spain does not need a bailout, something which Rajoy would obviously like to avoid because of the political cost it would carry.

The markets, however, can move in the other direction just as quickly.

Rajoy appears to using the current respite and the lack of a common position towards Spain among EU countries to gauge the conditions of a bailout. Germany is not convinced Spain needs a rescue, and fears a damaging impact on the eurozone, while France and Italy want Spain to go for it.

Rajoy has given no clues as to what he intends to do. In this sense he is true to the stereotype of people from Galicia, his home region in north-western Spain. According to a popular saying, a Galician is someone who, when met on the stairs, it is impossible to know whether he is going up or down.

Meanwhile, Spanish banks need €60 billion in new capital (see below) and it looks as if the government and not the European Stability Mechanism will shoulder the bill, which would increase its indebtedness. The EU bowed to German pressure at its summit on 18 October when Angela Merkel, the German Chancellor, insisted that direct recapitalisation of the banks could not happen until a single eurozone bank supervisor was in place and operating, which will not occur this year.

The business sector in Spain tends towards favouring a bailout, believing it would draw a line under Spain and end the uncertainty, while the trade unions have called for a general strike on 14 November against the austerity measures, the second one this year.

2013 Budget Battens Down the Spending Hatches, Previous Deficit Figures Revised Upwards

The budget for next year slashes ministry spending by 8.9% and freezes public sector wages for the third year running.

The deficit target is 4.5% of GDP (including social security, the regions and local governments) down from 7.3% this year. The initial figure for 2012 was 6.3% but this has been revised to take account of state aid to banks.

Among other key points are a new independent authority to monitor government finances, an increase in pensions funded by drawing on €3 billion of reserves, a new 20% tax on lottery wins above €2,500 and a new car scrapping scheme.

‘This is a crisis budget aimed at emerging from the crisis’, said Soraya Saenz de Santamaria, the Deputy Prime Minister.

Interest payments on the growing public debt are forecast to rise 33.8% to €38.6 billion (12% of total spending). The rise in this item is double that of the cuts in ministry spending.

Revenue is forecast to rise 4%, largely thanks to higher VAT receipts. The budget is based on a forecasted shrinkage in the economy of 0.5%, much lower than the IMF’s projection of negative growth of 1.3%.

The deficit figures for 2010 and 2011 were also revised upwards by Eurostat, the EU’s statistics unit, to 9.67% and 9.45% from 9.34% and 8.51%, respectively, in order to take account of various items including state aid to banks and payments by regional governments to suppliers.

IMF Says Spain will not Meet its Budget Deficit Targets

Spain will not meet the EU-imposed budget deficit target of 3% of GDP until 2017, three years later than agreed with Brussels. The government has already won a one-year extension (from 2013 to 2014).

Luis Linde, the Governor of the Bank of Spain, also cast doubts on meeting this year’s deficit. The government and the IMF, however, both agree on the scale of unemployment (see Figure 3).

Figure 3. IMF Forecasts for Spain, 2012-13

	2012	2013
Budget deficit (% of GDP)	7.0	5.7
Public debt (% of GDP)	90.7	96.9
Unemployment (%)	24.9	25.1
GDP growth (%)	-1.5	-1.3

Source: IMF.

The IMF said Mexico would surpass the size of the Spanish economy, in current dollars, in 2017 (see Figure 4).

Figure 4. The World's Largest Economies, 2012 and 2017 (US\$ bn)

	2012	2017
1. US	15,653	19,745
2. China	8,250	13,212
4. Germany	3,367	3,726
13. Spain	1,340	1,438
14. Mexico	1,163	1,490

Source: IMF.

Three More Regions Request Government Aid

The liquidity crisis in Spain's 17 autonomous regions deepened when three more regions requested aid from the central government.

The government created an €18 billion fund, €16.6 billion of which was requested by Catalonia (€5.4 billion), Andalusia (€4.9 billion), Valencia (€3.5 billion), Castile-La Mancha (€848 million), Murcia (€600 million) and this month by the Canary Islands (€756.8 million), the Balearic Islands (€355 million) and Asturias (€261.7 million).

The regions are shut out of the international bond markets and are struggling to meet the central-government-imposed budget deficit target of 1.5% of GDP this year.

Catalonia received a first tranche of €568 million this month, which it immediately used to pay hospitals and schools.

The finances of Castile-La Mancha are in such a bad shape that María Dolores de Cospedal, the head of the region's Popular Party government, has eliminated the salaries of the 49 members of the region's parliament. MPs now only get paid the monthly allowance for attending parliament (around €1,000).

The region's Socialist MPs said the measure discriminated against those who did not have other sources of income. While MPs were elected, the region's 56 advisors and 21 senior positions in the presidency were not and they earned a combined €3.2 million, three times the total salaries of MPs.

In Valencia, another PP-run region, the government announced it would shed 3,000 employees as a result of closing 46 of its 76 companies and foundations.

Banks' Capital Needs Put at €60 billion

Spain's banks need almost €60 billion in new capital, less than the €100 billion in EU aid the government requested in June, according to the results of the stress test carried out on 14 of the country's lenders (90% of assets) on the basis of an adverse scenario.

Including deferred tax assets and ongoing mergers, the shortfall is €53.7 billion.

Seven of the 14 banks failed the test, notably the nationalised Bankia, the product of the merger of seven ailing savings banks last year. Oliver Wyman, the consultancy, aided by the Big Four auditors and under the supervision of the European Central Bank and the International Monetary Fund, said Bankia, which requested €19 billion in state rescue money in May, needed a total of €24.7 billion in new capital.²

Bankia, together with three other banks (Catalunya Banc, NCG Banco and Banco de Valencia) majority-owned by the Fund for Orderly Bank Restructuring (FROB), account for 86% of the capital shortfall.

The three largest banks, Santander, BBVA and CaixaBank (accounting for 46% of assets) do not require any capital even under a highly unfavourable macroeconomic scenario.

Even in the most adverse scenario, Santander, the eurozone's largest bank by market capitalisation, would have a core capital of 10.8% in 2014, €25,297 million above the minimum requirement. It is the only bank that would end the analysed period (2011-14) with more capital than at the beginning.

The 'bottom up' review examined 115,000 loans (11% of the value of the sector's total credits) and followed a 'bottom down' assessment in June which concluded Spanish banks would need between €51 billion and €62 billion in new capital. That test failed five banks.

Madrid is hoping the latest test will finally allay the fears about the solvency of Spanish banks that have spooked international bond markets and helped push up Spain's 10-year yields. This test unlocks the EU rescue aid for those banks that need it.

Bad Loans Surpass 10% of Total Credit, Lending Shrinks

Non-performing loans (NPL) reached a record 10.5% of total credit in August and the volume of lending was 5.7% lower than a year earlier. The NPL ratio was a mere 0.6% in 2006 at the height of Spain's economic boom.

The rise was largely due to problematic real estate loans and the double impact of the increase in the numerator and the decline in the denominator from the fall in total lending.

Current Account Surplus in July, First Monthly One Since 1998

Spain recorded a current-account surplus of €499.7 million in July, the first monthly one since 1998, which helped to lower the deficit for the first seven months to €17.3 billion, 33% less than in the same period of 2011.

The trade deficit, however, was 15.4% higher in July at €1.27 billion because of the increased energy bill, but the deficit for January-July was €5.27 billion lower year-on-year at €16.77 billion.

² The full report is available at http://www.bde.es/f/webbde/SSICOM/20120928/informe_ow280912e.pdf.

The lower trade deficit coupled with the higher surplus on the services account (which includes tourism) of €20.53 billion (€18.12 billion in 2011) were the main factors that reduced the current account deficit.

The current account is forecast to be slightly in surplus in 2013 after reaching a deficit equivalent to 10% of GDP in 2008.

VAT rise Causes New Car Sales to Plummet...

Sales of new cars plunged by 38.6% in September over the same month of 2011 to 35,146 units, the worst monthly figure since records began to be kept in 1989 and largely as a result of the rise in VAT from 18% to 21%.

The total number of cars sold in the first nine months was 555,362. Anfac, the car producers' association, forecasts sales for the whole year at around 700,000.

The number could rise to 750,000 if consumers take advantage of the PIVE plan as of 1 October which lowers the cost of buying a new car by €2,000 (split between the government and the producer) if the car falls within an energy-efficient category and replaces one that is more than 12 years old.

... Pushes up Inflation and Puts Government in Pensions Quandary

Consumer prices rose to 3.5% year-on-year in September, the fastest pace in 16 months and up from 2.7% in August. The reason for this was the three-point rise in VAT.

The spurt in inflation could add to the government's woes on cutting the budget deficit because pensions are inflation-linked. Pensions will rise by 1% in 2013, but the government is so far refusing to say whether it will pay an inflation catch-up.

The government estimates that without the VAT rise, inflation would have been 1.4% and there was speculation that this might be the basis for the catch-up in 2013.

Spain's Inequality Rises and is among the most Skewed in the EU

The gap between the rich and the poor rose in Spain in 2011 to its highest level since records were kept.

The Gini coefficient, where zero is perfect equality and 100 absolute inequality, was 34.0, the second highest after Latvia (35.2) of the 16 EU countries that have so far provided figures to Eurostat (see Figure 5). The average for these countries is 5.7.

Figure 5. Gini coefficient of selected EU countries (1)

	2005	2011
Austria	26.2	26.3
Czech Republic	26.0	25.2
Germany	26.1	29.0
Poland	35.6	31.1
Spain	31.8	34.0
Sweden	23.4	24.4

(1) The Gini coefficient is defined as the relationship of cumulative shares of the population arranged according to the level of equalised disposable income, to the cumulative share of the equalised total disposable income received by them.

Source: Eurostat.

Spain's Gini coefficient remained more or less stable between 1995 and the onset of the crisis as of 2008.

A major factor behind the rise in inequality is that only two-thirds of the 4.7 million registered as jobless are receiving some kind of benefit or subsidy, and, according to the survey of those unemployed, all the members of more than 1.7 million households are without work.

Spain 44th in Ranking on the Ease of Doing Business

Spain's position in the World Bank's annual ranking on the ease of doing business remained unchanged at 44th, but it slipped two places to 136th out of 185 countries for starting a business (see Figure 6). It takes an average of 28 days to start a business (OECD average of 12) and 10 procedures (double the OECD average).

Figure 6. Ranking on the ease of doing business, 2013, selected countries (1)

1. Singapore
4. US
7. UK
20. Germany
34. France
43. Peru
44. Spain

(1) Out of 185.
Source: World Bank.

Corporate Scene

Acciona Wins €500 million Solar Power Contract in Morocco

Acciona, a major global player in renewable energy, together with Saudi Arabia's Acwa Power, won the contract to build a 160 MW solar power complex in Morocco near the city of Ouarzazate, at the edge of the Sahara Desert and among the foothills of the Atlas mountain range.

Gamesa Enters Finland

The wind energy company Gamesa is to supply 117 MW of turbines to Finland's TuuliWatti. They have been specifically made to withstand low temperatures.

Inditex Sustains Profit Growth, up 32%

Inditex, the world's largest fashion retailer by sales and the owner of Zara, posted a first-half net profit of €944 million, 32% higher than in the same period of 2011. It opened 166 stores, bringing the total number to 5,693 (1,930 in Spain).

Spain accounted for only 22% of sales, compared with 44% in the rest of Europe, 20% in Asia and 14% in the Americas.

Zara rose from 44th to 37th position in Interbrand's 2012 ranking of the world's most valuable brands (see Figure 7). Santander dropped from 68th to 76th place.

Figure 7. Top 100 most valuable brands in 2012 (1)

Brand and ranking	US\$ mn
1. Coca Cola	77,839 (+8%)
2. Apple	76,568 (+129%)
3. IBM	75,532 (+8%)
4. Google	69,726 (+26%)
37. Zara	9,488 (+18%)
76. Santander	4,771 (-6%)
100.GAP	3,731 (-8%)

(1) Change over 2011 in brackets.
Source: Interbrand.

Santander Pulls Out of Deal to Acquire 316 Branches in the UK

Santander, the euro zone's largest bank by market capitalisation, decided not to buy the 316 branches of the Royal Bank of Scotland in the UK, which it had agreed to do in August 2010 after the UK government's £45 billion rescue. The EU ordered the sale.

Santander blamed its decision on delays to the deal's completion.

Had it gone ahead, Santander, one of the UK's main banks, would have trebled its business with small and medium-sized companies.

Telefónica to Sell Part of German Subsidiary

Telefónica is to sell 23.17% of its German unit in order to use the estimated €1.5 billion proceeds to reduce its debt and protect its investment-grade rating.