Spain's recession: After the fiesta
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When a top soccer club in a country as fanatical about the game as Spain fails to pay its players, it is a warning that something may be drastically wrong with one of Europe's most successful economies.

David Villa, scorer of Spain's first goal in the victory last week over England in Seville, is a member of the Valencia squad whose latest salary payment has been delayed indefinitely by the heavily indebted club. He is just one of the growing number of victims, rich and poor, of a plunge into a recession that is on course to be among the steepest in Europe.

The strains are starting to show in Spain's normally easygoing society. African residents and street hawkers demonstrated twice last week in the Madrid district of Lavapiés against alleged racism and police raids; it subsequently emerged that police in the capital had been given weekly quotas for arresting illegal immigrants. In Andalucia to the south, thousands of other immigrants without food or shelter flooded into country towns at the start of the winter, hunting in vain for olive harvesting work that had already been taken by Spanish job-seekers.

Cranes stand idle on half-finished housing estates along the coast and on the outskirts of big cities. Many small shops in central Madrid have closed. One building company owner ruined by the economic crisis stands accused of five bank hold-ups; another threatened to set fire to himself unless the local council paid him the €450,000 ($566,000, £397,500) it owed.

"We're not going to have a recession. We're going to have a depression like in the 1930s," says Lorenzo Bernaldo de Quirós, economist and chairman of Freemarket International Consulting. He is one of the more pessimistic analysts but justifies his gloom by pointing at predictions that are widely shared: unemployment at 19 per cent of the workforce by the end of the year (up from more than 14 per cent, or 3.3m people, now); a budget deficit of at least 6.5 per cent of gross domestic product; economic contraction of 3 per cent or more in 2009; and possible deflation. "This is the perfect framework, together with a financial crisis, for a depression," he concludes.

That could hit what is one of the world's top 10 economies, and the fourth largest member of the eurozone, so severely that it could lose many of the gains made in the decade since the introduction of the common currency.

Until the global economic crisis hit, the country had performed well. Its return to democracy and prosperity after a civil war and the dictatorship of Francisco Franco is, after all, one of the great success stories of postwar Europe. In the decade to 2006, real growth ran at an annual average of 3.7 per cent, compared with 2.1 per cent for the rest of the eurozone. Per head, GDP has risen to more than 90 per cent of the average for the European Union's core 15 western member states.

This expansion helped to create more than 5m jobs and draw in more immigrants as a proportion of the population than anywhere else on the Continent. Construction, especially housebuilding financed by easy credit, was the main driver of the economy for a decade – and therein lies the source of the difficulties. As in the US and Britain, the property bubble has burst with a vengeance.

An estimated 1m newly built flats and houses lie empty in Spain. Housebuilding – which accounted directly for 7.5 per cent of GDP in 2006 – is grinding to a halt. The lobby group representing 14 big property developers said on Tuesday that they had started not a single new house in December and only 135 in the whole final quarter of 2008. Total housing starts peaked at more than 700,000 units in 2006. "The pattern of growth in the Spanish economy during 15 years has been based on financial markets that were very liquid – a lot of liquidity *and* cheap liquidity," says Rafael Doménech, chief economist for Europe of BBVA, the Spanish bank. "It was optimal for the Spanish economy, for households and for firms to use that liquidity to increase their debt."

And so they did. Private sector debt doubled in a decade to 120 per cent of GDP. With much of the credit coming from German pensioners and other savers via Spanish mortgage-backed securities, the current account deficit hit more than 10 per cent of GDP. With a changed environment in the financial markets, says Mr Doménech, "we cannot expect to use the same growth model as in the last 10 years".

In theory, Spain could replace the lost construction activity with increased output in other sectors. It is one of the world's more open economies and its companies in fashion, renewable energy, infrastructure and banking have been active exporters and investors overseas. But other economies are in no position to take up the slack. Spain's automotive industry, which makes up one-fifth of the country's exports and 6 per cent of GDP, is struggling to deal with a collapse in demand at home and abroad. Tourism is a €50bn business but arrivals fell 3 per cent last year, the first year-on-year decline since the current measuring system was introduced in 1997.

José Luis Rodríguez Zapatero, the Socialist prime minister, has taken the same route as other crisis-hit leaders around the world and announced a blizzard of state spending plans (there were more than 90 separate anti-crisis measures at the last count) in an attempt to slow the rise in unemployment and stave off a prolonged depression. Miguel Sebastián, his industry minister, has flirted with protectionism – although he denies the charge – by launching a "Buy Spanish" campaign.

Yet there is no certainty that the spending measures – some of them announced over the objections of Pedro Solbes, finance minister and former guarantor of fiscal restraint – will have the required effect. What is certain is that the government's fiscal room for manoeuvre, with the projected budget deficit already more than double the EU's permitted ceiling of 3 per cent of GDP, is severely limited. Although accumulated public debt remains relatively modest, the deterioration of public finances prompted Standard & Poor's to remove Spain's triple-A credit rating last month.

In previous crises, Spain simply devalued its peseta to improve the competitiveness of its exports and attract investment – the path now being taken by the UK and the free-floating pound – but a unilateral devaluation is no longer an option for a member of the single currency zone.

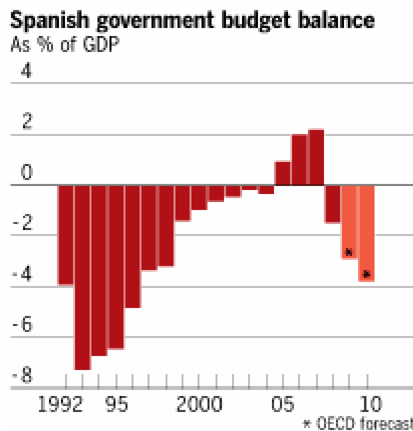
Almost every chief executive, orthodox economist and rightwing opposition politician in the country concludes that the only way for Spain to emerge stronger from the crisis – indeed, to survive it within the confines of the eurozone – is for it to improve productivity and competitiveness by adopting structural reforms. By that they usually mean that employees could be hired and fired more easily and cheaply and wages would be set by companies rather than entire industries.

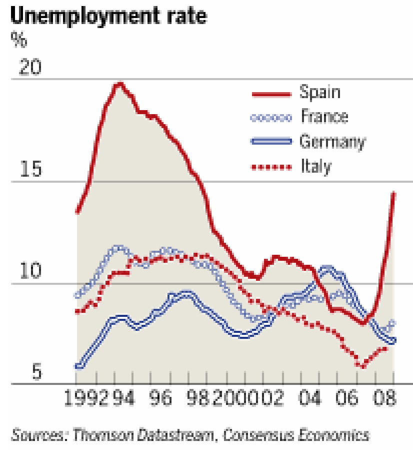
Miguel Angel Fernández Ordóñez, governor of the central bank, entered the debate last week, irritating the government by calling labour reform the "most important" measure to cut unemployment. There is no sign that Mr Zapatero will embark on any such vigorous programme, but even if he did it would take time to have an impact.

In the meantime, an end to Spain's outperformance leaves open the question of whether it can all restart when the global crisis ends. Construction was such an important part of growth that recovery will inevitably be slow, economists say. "Probably at the end of three or four years – it is difficult to know when – Spain's per capita income will accelerate significantly again,

reducing the gap with other EU economies," says Mr Doménech.

That, however, is one of the more optimistic forecasts. Mr Bernaldo de Quirós is not so cheerful. "The Spanish economy won't start to grow at 3 per cent for about seven years. Spaniards will lose half their wealth," he says. "It's horrible."





AS TILES LOSE THEIR LUSTRE, VILLARREAL STRUGGLES TO COVER THE CRACKS IN AN INDUSTRIAL MONOCULTURE

To the first-time visitor, it may be surprising how many buildings in Villarreal, an otherwise nondescript industrial town in eastern Spain, are faced with ceramic tiles: an office block in shiny white here, a civic monument in matt black there. Even the walls of the soccer stadium have been decorated with yellow tiles.

That is because Villarreal lives and dies by the ceramic tile industry. The town of 51,000 and the surrounding area of Castellón province account for more than 90 per cent of Spain's decorative tile output, with 220 tile factories and 24 glaze producers.

Yet the industry that has replaced citrus growing as Villarreal's main provider of wealth and jobs is in serious trouble. "Fear," says Joaquín Font de Mora, general manager of Vidres, a glaze maker, when asked to describe the mood in Villarreal. "Fear of losing one's job. Each month you can see that there are companies laying people off."

The collapse of Spain's previously frenzied home construction sector has had a catastrophic effect on demand for tiles. "There was lots of talk of the property bubble bursting, but we didn't think it would be so sudden," says Mr Font de Mora, speaking at his company's stand at the Cevisama ceramics trade fair in Valencia. As expected, demand slackened in 2007 and 2008. "But between November 2008 and February this year, it's been barbaric."

With stocks of unsold tiles piling up, many manufacturers and their suppliers have cancelled overtime, shed workers or even suspended operations. "There's lots of supply and not much demand," says Antonio Piquer Saura, co-director of Rocersa Cerámica, one of the larger family-owned tile makers, which has 280 employees and annual turnover of about €60m ($76m, £53m). "Quite a few companies have closed and others have reduced production."

For Juan José Rubert, mayor of Villarreal and also an economics professor, the fate of the town is a textbook example of the dangers of overdependence on a single industry. "It's an industrial monoculture," he says. "Each job that is lost in a ceramics factory can cause one or two more job losses in connected industries. What was once a virtuous circle is now a vicious circle."

As in the rest of Spain, building sites lie idle, with construction companies not bothering to finish blocks of flats they will be unable to sell. Some of the *Se vende* and *Se alquila* signs offering new homes for sale or rent have been on display for two years.

No obvious relief for Villarreal is in sight. Business owners and the local government, which is run by the rightwing Popular party, the national opposition, are sceptical about the multi-billion euro nationwide spending plans announced by José Luis Rodríguez Zapatero, the Socialist prime minister.

Diversification into other sectors of the economy seems an attractive long-term option, although it is hard to imagine any business that could provide as many jobs as the huge ceramic tile factories that dominate the roads into the town.

Spain's east coast citrus farms are already suffering as a result of intense competition from growers in North Africa. Tourism is an equally long shot for Villarreal – the town is obviously industrial and the beaches are 5km away.

The tile companies are hoping that exports and retail sales in Spain for home improvements will tide them over until the new homes market starts to recover. "We hope that in 2010 little by little Spanish demand will return," says Mr Font de Mora, gesturing philosophically to a bottle of Rioja. "You have to see the bottle as half full rather than half empty as long as there is any liquid left."

Scorned south

Eurozone governments have kept a keen eye on the worrying propensity of investors to rank some single-currency members as more of a credit risk than others. The gap between interest rates on bonds from best-in-class Germany and those required of presumed laggards – Spain, Greece, Portugal, Ireland and Italy – has grown to record levels in recent months, *writes Gerrit Wiesmann*.

The danger that higher spending and rising interest payments could push some countries towards default has prompted Giulio Tremonti, Italy's finance minister, to float the idea of a bond issued collectively by the European Union – a proposal widely rejected on the grounds that it would free governments from taking responsibility for their policies.

Jean-Claude Trichet, president of the European Central Bank, said this month that, as each eurozone country was responsible for its budget, so it should be responsible for financing it – although he noted that EU members controlled the European Investment Bank, which could raise money cheaply for anything the EU saw fit.

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