



EUROPEAN CENTRAL BANK

EUROSYSTEM

STRICTLY CONFIDENTIAL

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Mr. José Luis Rodríguez Zapatero  
Prime Minister  
Presidente del Gobierno de España  
Complejo de la Moncloa  
Avenida de Puerta de Hierro, s/n  
28071 Madrid  
Spain

Frankfurt/Madrid, 5 August 2011

Dear Prime Minister,

The Governing Council of the European Central Bank discussed on 4 August 2011 the situation in Spain's government bond markets. The Governing Council considers that for Spain pressing action by the Spanish authorities is essential to restore the credibility of the sovereign's signature in capital markets.

We recall that the Euro area Heads of State or Government summit of 21 July 2011 concluded that "*all euro countries solemnly reaffirm their inflexible determination to honour fully their own individual sovereign signature and all their commitments to sustainable fiscal conditions and structural reforms*". The Governing Council considers that Spain needs to urgently underpin the standing of its sovereign signature and its commitment to fiscal sustainability and structural reforms with credible evidence.

At the current juncture, we consider the following measures to be essential:

1. We see a need for further significant measures to improve the **functioning of the labour market** with a view to making clear progress towards reducing the very high rate of unemployment.

a) The wage-bargaining reform bill adopted by the Spanish government on 10 June 2011 should more effectively strengthen the role of firm-level agreements, with a view to ensuring an effective decentralisation of wage negotiations. During the forthcoming parliamentary process, the law should be amended in order to reduce the possibility for industry-level agreements (at national or regional level) to limit the applicability of firm-level agreements.

b) Furthermore, we remain very concerned that the government has not taken any measures to abolish inflation-adjustment clauses. Such clauses are not an appropriate feature for labour markets inside a Monetary Union as they are a structural obstacle to the adjustment of labour costs and thereby contribute to hampering competitiveness and growth. We encourage the government to take bold and exceptional steps to exclude the use of such clauses in view of the current crisis.

c) The government should also take exceptional action to encourage private sector wage moderation, following the significant cuts in public wages agreed last year. We invite the government to explore all possible avenues to this end.

d) We also suggest reviewing other labour market regulations at short notice, with a view to speeding up the reintegration of unemployed into the labour market. We see strong benefits in introducing an exceptional new labour contract with only very low severance payments, to be applied for a limited period of time. In addition, we suggest eliminating all restrictions for the roll-over of temporary contracts for a certain period of time.

In view of the severity of the financial market situation, we regard as crucial that action in the above fields be taken as soon as possible, but at the latest by end-August.

2. The government also needs to take bold measures to ensuring the **sustainability of public finances**.

a) The government should clearly demonstrate with actions its unconditional commitment to meeting its fiscal policy targets independent of the economic situation. To this end, we urge the government to announce already in August additional structural fiscal consolidation measures for the remainder of 2011 of above 0.5% of GDP as a minimum with a view to convincing markets that the 6% deficit target for 2011 will be reached under all circumstances. At the same time, strict implementation of the national fiscal rules to ensure control of regional and local government budgets (including the authorisation of regional government debt issuance) must continue and additional adjustments to regional and local government consolidation plans implemented swiftly when needed.

b) The recent publication of quarterly data on the budget execution of regional governments is an important step forward in terms of transparency; but it does not go far enough. The government should publish in the short term national accounts for each government sub-sector in conjunction with the publication of quarterly government finance statistics. In addition, in the medium-term, the government should encourage the publication of monthly national accounts data for other government sub-sectors with the same detail and timeliness as for central government.

c) The introduction of a new spending rule (limiting spending increases in normal times to the trend growth rate of GDP, unless financed by changes to tax legislation) is welcome. It is key that this rule applies in the future to all government sub-sectors.

3. Finally, we encourage the government to undertake further **product market reforms**. Several elements should be addressed here:

- i) increasing competition in the energy sector, so that prices better reflect the cost of energy, as well as taking measures to reduce the high energy dependence of the Spanish economy;
- ii) promoting the rental market for housing, by improving the regulation of contracts; and
- iii) increasing competition in the services sector, by specifically addressing the regulation of professional services.

Overall, we trust that the Spanish government is aware of its very high responsibility for the smooth functioning of the euro area at the current juncture and will decisively undertake all necessary measures to regain market confidence in the sustainability of its policies again. Such actions, together with all measures underway to restructure and recapitalise the Spanish banking sector, should lead to high benefits not only for the Spanish economy but also for the euro area as a whole.

With best regards,



Jean-Claude Trichet



Miguel Fernández Ordoñez

*Cc: Finance Minister Elena Salgado*