Spanish Reliance on Building Is Serious Economic Risk, S&P Says

By John Fraher

April 3 (Bloomberg) -- Spain's reliance on construction as an engine of growth poses a ``major risk'' to the country's economic prospects as higher interest rates threaten to end a property-market boom, Standard & Poor's said.

``We consider this red-hot and unbalanced construction sector to be a major risk to the economy as a whole,'' said Jean-Michel Six, London-based chief European economist at the credit-rating and research company, in a report published today.

Seven rate increases by the European Central Bank since the end of 2005 and the prospect of further moves in the future are curbing house-price inflation in Spain, which slowed below 10 percent in the fourth quarter for the first time since 1999.

Property agents in Spain are likely to cut vacation home prices by as much as 10 percent this year, says RR de Acuna & Associates in Madrid, which values real estate for about 40 percent of mortgages. Spanish household debt rose to 118 percent of income from 50 percent a decade ago as house prices tripled.

That leaves homeowners ``very exposed to a market downturn,'' according to S&P. The ECB last month increased its main rate to 3.75 percent and banks including Unicredit Market & Investment Banking and ABN Amro Holding NV expect the benchmark to exceed 4 percent this year.

Housing Market

For Europe's housing market as a whole, S&P said it's optimistic property owners will avoid a slump as severe as the collapse in the U.S. subprime market. While house prices in Germany, Europe's largest economy, have stagnated over the past decade, values have surged in France, Spain, the Netherlands and Ireland.

``The potentially corrosive effects of higher interest rates are being counterbalanced by strong economic prospects and a highly competitive financial industry,'' said Six, who wrote today's report with credit analyst Andrew South. ``Europe's housing markets will largely avoid a hard landing.''

Recent reports have sent mixed signals about the health of Europe's housing market. Irish property values stagnated for the first time in more than four years in February and French housing starts plunged 15.1 percent in the three months through February, the steepest drop since January 2001.

House Prices

U.K. house-price inflation, which accelerated to the fastest pace in almost four years in March, may slow later this year, according to S&P. The Bank of England has raised its main rate three times since August, taking it to 5.25 percent.

``As first-time buyers find it harder to enter the market, we would expect house-price growth and mortgage lending to decelerate more markedly from the second half,'' according to S&P.

In the U.S., a meltdown in the subprime mortgage market for loans to borrowers with poor credit histories has heightened concern the housing slowdown will spill over to the broader economy. More than 30 lenders have halted operations, gone bankrupt or sought buyers in the past 12 months as defaults on subprime loans surged.

To contact the reporter on this story: John Fraher in London at **jfraher@bloomberg.net**

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