Spain tips into depression

Spain is sliding into a full-blown economic depression with unemployment approaching levels not seen since the Second Republic of the 1930s and little chance of recovery until well into the next decade, according to a clutch of reports over recent days.

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Bull run is over: Spain is sliding into a full-blown economic depression akin to that seen in the 1930s Photo: AP

The Madrid research group RR de Acuña & Asociados said the collapse of Spain's building industry will cause the economy to contract for the next three years, with a peak to trough loss of over 11pc of GDP. The grim forecast is starkly at odds with claims by premier Jose Luis Zapatero, who still says Spain's recession will be milder than elsewhere in Europe.

RR de Acuña said the overhang of unsold properties on the market, or still being built, has reached 1,623,000 . This dwarfs annual demand of 218,000, and will take six or seven years to clear. The group said Spain's unemployment will peak at around 25pc, comparable to the worst chapter of the Great Depression.

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Spanish workers typically receive 50pc to 60pc of their former pay for eighteen months after losing their job. Then the guillotine falls. Spain's parliament has rushed through a law guaranteeing €420 a month for longterm unemployed, but this will not prevent a social crisis if the slump drags on.

Separately, UBS said unemployment will reach 4.8m and may go as high as 5.4m if the job purge in the service sector gathers pace. There is the growing risk of a "Lost Decade" akin to Japan's malaise after the Nikkei bubble.

Roberto Ruiz, the bank's Spain strategist, said salaries must fall by 10pc in real terms to regain lost competitiveness, replicating the sort of wage squeeze seen in Germany after reunification.

There is no sign yet that either Spanish trade unions or the Zapatero government are ready for such draconian measures. Talks between the unions and Spain's industry federation (CEOE) broke down in acrimony in July.

Mr Ruiz said the construction sector will shrink from 18pc of GDP at the peak of the boom to around 5pc, making it unlikely that there will be any significant recovery before 2012. Even then growth will be "slow, weak, and fragile".

The Spanish government can do little to cushion the downturn. "The room for manouvre in fiscal policy has been exhausted," said Mr Ruiz.

The rocketing cost of jobless benefits has added 3pc of GDP to the budget deficit. Mr Zapatero has ordered all ministries to cut 8pc of discretionary spending to help plug the gap left by collapsing tax revenues. The axe is likely to fall on research and big projects such as high-speed railways.

The root cause of Spain's trouble is that it joined monetary union before its economy was ready. EMU halved Spanish interest rates almost overnight. Real rates were minus 2pc for much of this decade. Combined private and corporate debt reached 230pc of GDP, funded by French and German savings.

The credit boom masked a steady decline in productivity over the last decade. Spain's unit labour costs have risen by about 30pc compared to Germany.

The Bank of Spain made heroic efforts to counter the effects of the bubble by forcing banks to put aside extra reserves, known as dynamic provisioning, but the sheer scale of the problem has washed over the defences.

Spain no longer has the escape valve of devaluation to claw back market share. It cannot resort to emergency monetary stimulus – as Switzerland, Britain, the US, and Japan are doing to prevent the onset of debt deflation. Prices are already falling at a rate of 1.2pc.

Jamie Dannhauser from Lombard Street Research said Spain is bearing the full brunt of the European Central Bank's restrictive monetary policy, which has caused private sector credit in the eurozone to shrink over the last six months.

The latest ECB data shows that 60pc of Spanish firms have seen access to credit fall so far this year. Most say they have been denied their full request for loans or credit lines.

Mr Dannhauser said Spain faces the same sort of boom-bust headache as Britain. The big difference is that Spain cannot let the exchange rate take the strain. "It is going to be very hard for them to sort this out in a currency union."

For the time being, an odd calm prevails across the Iberian peninsular. There are no street riots, even though youth unemployment has reached 38pc. It is hard to imagine anything like the bloody uprising by Asturian miners in 1934, the last time so many people were without jobs.

Local communities have started to issue scrip currency known as "moneda social", based on reflation experiments tried by Austrian cantons in 1932 and more recently by Argentina. Yet few blame the crisis on the effects of the euro. There is a near total backing for EMU, in contrast to France and Germany where a small but vocal minority has never accepted the wisdom of Europe's one-size-fits-all system.

Membership of the EU and the euro is inextracably linked in Spain's collective mind to the country's re-emergence as a modern, dynamic European power after the stultifying isolation of the Franco dictatorship. It would take a major trauma to test that bond.

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