

## The “japanization” of Spain \*

For six months now, economists have been absorbed in the task of searching for the little green shoots which will signal an end to the recession but with dismal results: nothing. In the case of Spain, at least. However, in countries like Germany, France, Japan, China or the U.S.A., there do appear to be positive signs. So why should the situation be so different for Spain? Probably because the magnitude and the consequences of the Spanish property bubble have not been correctly assessed.



During its development years, the bubble grew, boosted by low-interest monetary policy – in practice, negative real interest rates – imposed from Frankfurt and over which Spain has had very little control since joining the euro. The application of fiscal policies to curb runaway activity in the property market would have been possible, but successive governments did not consider it convenient to assume the political cost of such decisions. After all, who wants to take the whisky away from the party when everyone is having such a good time?

The property bubble makes us different from countries like France and Germany, but is a situation we have in common with the U.S.A. and the U.K. The only difference between us and them is what happened after the bubble: sharp falls in prices combined with the depreciation of the dollar and the pound made property asset prices more reasonable again in those countries. That has not happened in Spain. According to the Spanish Property Markets Index published yesterday by TINSA, the decrease in the average price of a house compared with the highest values in December 2007 stands at 14%, a long way off the 30-35% overvaluation which several international institutions were estimating a couple of years ago.

As with the 1993 crisis, the relative stability of prices in the property market is explained by the phenomenon which economists call “market illiquidity”, which is the same as saying, nobody in their right mind is prepared to pay the asking prices for properties (the Housing Ministry also published figures yesterday

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relating to house sales which continued in free fall during the first half of the year, dropping more than 30% compared with the same period last year). Faced with this situation, there are two options : reduce prices until they go back to being attractive enough for potential buyers, or keep the property in the hope of better times to come, under the misapprehension of "*if I don't sell up, I won't lose out*". Financial institutions have thus become the biggest estate agents in the country, and that certainly does not contribute to regaining confidence but it does promote complacency.

The "Titanic effect" seems to be at work: as the vessel develops a noticeable tilt, the band plays on and they have just handed us a 420€ voucher to have a few drinks

That strategy worked in 1993 and the recovery of the property market in the following years allowed financial institutions to get rid of their property portfolios without too much trouble. Unfortunately, we are not in 1993 and the disappearance of the peseta makes it impossible to resort to the devaluations which at that time spurred a rapid recovery and the acquisition of many of those property assets by foreign citizens who took advantage of an attractive exchange rate. Paradoxically, today, the situation is exactly the opposite, with the pound devalued against the euro, making it unaffordable for a British citizen to acquire a property in Spain.

At this point we now have some good and bad news to deliver. The good news is that the impossibility of taking action on monetary policy does not necessarily exhaust all the possibilities. The bad news is that the majority of the measures taken by the government until now, are taking us nearer and nearer to the situation in which the crisis develops a cyst or to the "japanization" of the Spanish economy, in reference to its "lost decade".

The future depends, to a great extent, on the decisions the government takes. And in theory, there is a striking consensus: coming out of the crisis involves raising productivity which favours the competitiveness of our companies and a change in the productive model which fills the gap left by the once-booming construction industry of the past. The more-than likely increase in energy costs in the mid-term, the progressive mercantilization of the effects on the environment, and rising global competition in low value-added sectors are clear indications of the path to be followed.

The reality of government action, however, shows it to be following a very different course, with current non-productive public spending a priority, in an attempt to achieve greater social cohesion. The "Titanic effect" seems to be at work: as the vessel develops a noticeable tilt, the band plays on and they have just handed us a 420€ voucher to have a few drinks. The situation doesn't seem so bad after all.

The effect of the anti-crisis "rebate" of 400€ worth of income tax is yet to be revealed. The first Plan E has cost each Spanish family 563€. We will have to

look on the pavements of our cities to see its effect on future productivity. The withdrawal of tax incentives for house purchases in 2011 will, when it takes effect, cause a further fall in house prices. In short, the future holds the prospects of either a huge deficit which will relegate us to the tail of the two-speed European Union which our northern neighbours are beginning to talk about or an entirely immoderate increase in fiscal pressure, quite the contrary to what Zapatero declared yesterday in the Chamber of Deputies, causing the horizon of recovery to recede further into the distance for the long-term future.

The need for a government agreement which allows for a change in model and goes further than mere rhetoric is becoming more and more pressing. And it must be established not only in educational matters, (which while essential, will not have any visible effects for over a decade) but also in economic matters. We are not Japan and we cannot wait ten years.

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