

6 March 2008

# Economic News

## PARLIAMENTARY ELECTIONS IN SPAIN

### Who can put a brake on the downturn?

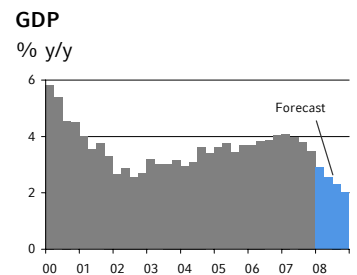
On 9 March Spanish voters will elect a new parliament. The serious deterioration of Spain's economic situation in recent months could prove to be a bitter pill for the governing Socialists. Socialists and Conservatives are currently vying to outdo each other in proposing measures to promote growth.

- The governing Socialists (PSOE) under Prime Minister Zapatero and the conservative People's Party (PP) under its leader, Mariano Rajoy, are locked in a neck-and-neck race. The most recent survey showed the Socialists ahead by only 4 percentage points. The dominant campaign issues centre on the Spanish regions' demands for autonomy and the possibility of cushioning Spain's economic downturn.

#### Comparison of the key measures in the parties' election platforms

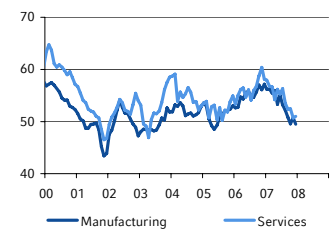
Socialists (PSOE)	Conservatives (PP)
<ul style="list-style-type: none"> <li>■ One-time tax refund of €400 per taxpayer in June</li> <li>■ Minimum wage hike to €800 by 2012</li> <li>■ Value-added tax refund to be on a quarterly instead of an annual basis in a bid to improve the corporate financial situation</li> <li>■ Simplification of the VAT</li> <li>■ Establishment of a public-sector credit line for SMEs</li> <li>■ Tax incentives to increase the amount of venture capital available for business start-ups</li> </ul>	<p>Income and corporate tax reform:</p> <ul style="list-style-type: none"> <li>■ Income tax exemptions for incomes below €16,000; €1,000 deduction for employed women</li> <li>■ Establishment of three income tax brackets with tax rates of 20%, 30% and 40%</li> <li>■ Corporate tax reduction: from 25% to 20% for SMEs and from 30% to 25% for all others</li> <li>■ Additional 5 percentage point corporate tax rate reduction in 2011, provided the 3.8% growth target is achieved</li> <li>■ Abolition of the wealth tax</li> </ul>

- Although the Spanish economy grew 3.8% on average last year, there are clear signs of a downturn. The current year's annual GDP growth contracted from 3.9% in the first half to 3.0% in the second half-year. Private consumption growth slumped to 1.6% (annualised annual rate) in the second half from 3.7% in the first half-year. The real estate sector has deteriorated further as a result of the US subprime crisis – tighter credit restrictions, higher risk aversion and increased caution in the real estate business. The business climate in the construction industry has slid into negative territory for the first time after a long period. The contribution to growth from construction investment, which averaged nearly 1 percentage point over the past few years, is expected to disappear altogether this year.



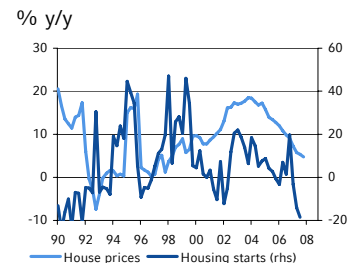
Source EcoWin, WestLB Research

#### Purchasing managers' indices



Source EcoWin, WestLB Research

#### Real estate market



Source EcoWin, WestLB Research

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The absence of construction as a pillar for economic growth cannot currently be compensated for. The export sector, performing poorly as it is, is being additionally hurt by the slowdown of growth in the neighbouring countries.

- Against this backdrop, the spending behaviour of private households has become more cautious. Household incomes have deteriorated as a result of a lower rise in employment and smaller gains in real income. A significant weakening of private consumption would have serious implications for the growth rates of the overall economy, as private consumption accounts for around 60% of GDP.
- The political parties are vying to outdo each other in proposing measures to promote growth. The most notable measures are, on the one hand, the one-time payment of €400 per taxpayer as proposed by the Socialists and modelled on the US practice of issuing tax refund cheques and, on the other, the Conservatives' proposal of reducing income and corporate tax rates. The catalogues of measures reflect the respective party ideology. Whereas the Conservatives are focussing primarily on tax relief measures for companies and households, the Socialists are endorsing increased state subsidies. Both parties are in favour of utilising budget surpluses to stimulate growth. While the measures proposed by the Socialists are primarily designed to deliver short-term benefits, the tax reduction proposal of the Conservatives is designed to unfold its intended effects in the medium-term, with a potentially more sustainable impact. While the parties are busy outdoing each other on measures to promote short-term growth, the problem of lack of international competitiveness is barely being addressed. How this is to be improved still remains largely unclear.

### Spain

	2004	2005	2006	2007	2008	2009
GDP (in % y/y)	3.3	3.6	3.9	3.8	2.5	2.0
Consumer prices (in % y/y)	3.1	3.4	3.6	2.8	3.8	2.7
Unemployment rate (in %)	11.0	9.2	8.5	8.3	9.5	10
Budget Balance (in % of GDP)	-0.3	1.0	1.8	2.2	1.0	-0.5
Current Account Balance (in % of GDP)	-5.3	-7.4	-8.6	-10	-9	-8

Source: National statistics – 2008/09: WestLB forecasts.

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