

THE SPANISH CONSTRUCTION SECTOR, MIRACLE OR MIRAGE?

How a wrong economic policy pursued over a decade can affect the whole Spanish economy

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Agustín Bou discusses how a decade of pursuing an ill-advised economic policy has had a detrimental effect on the whole Spanish economy

When something can go wrong, it does go wrong. Unfortunately this proverb is fully applicable to the present situation of the Spanish construction sector. When one analyses the present economic situation in Spain, one tends to think that the situation is equivalent to that in other jurisdictions; this approach stems from a false premise, for the present crisis has had some special features in its impact on the Spanish economy.

A crisis in construction

On the one hand, the financial crisis has so far affected the Spanish banks less severely than banks in other jurisdictions. Fortunately, our banks did not take on exposure to the subprime market, but on the other hand the Spanish economy as a whole was too deeply and too riskily based on the construction sector, and thus the impact of the construction crisis on our economy has been much higher than it has been in other western economies.

Spain has been incubating its present crisis over the past ten years under the cover of the boom in the construction sector. Ten years ago, the percentage of Spain's GDP attributable to the construction sector was not different from that of other developed economies. Each year, the degree of dependence became progressively greater, to the point of a dependence of more than 16 per cent of our GDP on the construction sector in 2007. That is an excessively high level for a sector of these characteristics, especially if we bear in mind that its rise

was due to a steady fall of industrial sector GDP. The elements for a perfect storm had been attained.

Historical factors

Historically, many factors have contributed to producing this situation: cheap money; mistaken policies to enlarge the area of available urban building land, for it was assumed that high housing prices were due to the shortage of it; the complex financial structure of Spanish regional and municipal governments, which makes them highly dependent on real-estate development and pushed them into a headlong race to incessant development of building land, etc.

All these factors were inevitably dragging the country into an unsustainable situation, although the operators hoped that they would have a soft landing. Unfortunately that has not happened, largely -as the real-estate crisis in other economies such as Ireland's shows- on account of the world recession. However, there have also been many specifically local features that contributed and are still contributing to make our own situation worse. One of the main ones is the bad management of the crisis by the Spanish government, which throughout late 2007 and much of 2008 repeatedly refused to acknowledge the existence of the economic crisis. This denial applied to both the real-estate sector and to the Spanish economy in general, and so wasted precious time in adopting measures to reduce its impact. To this must be added the government's economic policies of a clearly populist nature, which will unfortunately greatly lengthen the time needed by Spain to come out of the recession.

Banking losses

We should also bear in mind that Spanish banks have not yet taken stock of the huge losses that the real-estate crisis is causing in their balances. In many cases recently they have granted refinancing to businesses of doubtful future solvency, and in other cases have assigned mortgaged property to real-estate subsidiaries so as not to have to incorporate them as losses in their own

balances. When these properties come to be sold at the real market price, the banks will have to record in their books the loss that they represent; so one can foresee that their results in the coming two years are going to register a serious negative impact.

It is difficult to predict how much time the construction sector is going to need to recover from this crisis, but our impression is that the worst is yet to come. Building companies will have to address the enormous financial commitments they have entered into with the banks, without having the resources to do so. That will inevitably provoke in Spain a financial crisis that will involve a merger of banking institutions and even the disappearance of some of them.

The mirage disappears

It is clear that Spain has exhausted an economic model on which it should never have relied so much, and will need to take alternative approaches to the future based on other sectors of the productive economy. This will be extremely difficult. After years of thinking we were living in a miracle, we have suddenly discovered that we were living in a mirage, and we now have ahead of us a tough trek through the desert of reality.