

Spanish Labour Market Monitor

Presentation

Unemployment recorded a historic fall in June (98,853), a third of which translates into increased Social Security enrolment in the same month (specifically, 31,332), but this will not prevent the second quarter data being much worse than those of the two previous years. We expect an increase in employment on the order of 52,000 (down 4.5% YoY), compared to 151,000 and 83,000 in 2011 and 2010 respectively. With regard to the unemployment rate, we expect it to stay around 24.4%. Forecasts for the next three months see employment falling below the minimum observed in March (17.3 million).

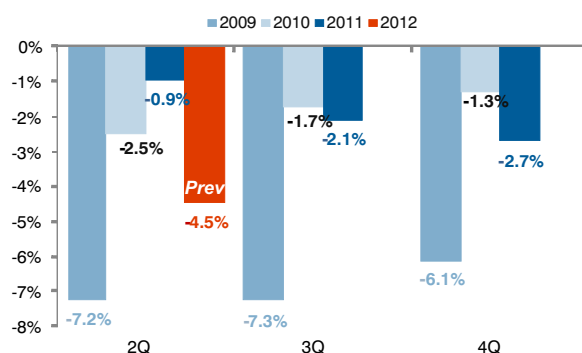
Key Points

- Registered unemployment decreased by 98,853 in June, a historic reduction that will not prevent the second quarter data being much worse than those of the two previous years.
- In this regard, we expect the EPA labour force survey for the second quarter to record growth in employment on the order of 52,000 (but down 4.5% YoY), compared to 151,000 and 83,000 in 2011 and 2010 respectively. With regard to the unemployment rate, we expect it to stay around 24.4%.
- A third of the decline in unemployment is reflected in the increase in enrolment. To find out if there has been a shift towards inactivity, we will have to wait for the 2Q12 EPA data, published on 27th July.
- The hotels and catering sector and the regularization of domestic employees are responsible for the bulk of the increase in enrolment in June.
- With regard to recruitment, the number of full-time contracts declined, though there was a slight increase in the case of the permanent part-time workers.
- The percentage of unemployed covered by benefit continues to decline and in May stood at 65.4%, when a year ago it was almost 70%.
- The misery index, which reveals the impact of the crisis in terms of the deterioration in living standards (unemployment rate and inflation), stood at 26.4% in 1Q12, 16 percentage points higher than pre-crisis levels and 1.6 percentage points higher than in 1Q11.
- Andalusia, Extremadura and the Canary Islands remain the Spanish regions with the highest misery index, while it was lowest in Navarre and the Basque Country in 1Q12.
- The regions which have seen the greatest deterioration in the misery index are Extremadura, Castile-La Mancha and La Rioja (more than 3 percentage points), while those which have succeeded in reducing it are Murcia and Aragon (almost one percentage point less than in 1Q11).
- Spain had the highest misery index in Europe in 1Q12, but it did not see the biggest increase over last year (in Greece, Italy and Cyprus the misery index rose by more than 3 percentage points).
- Austria, Holland, Malta, Germany, Luxembourg and Sweden are the European countries with the lowest misery indices (less than 10%).

Afi-Agett SLM Indicator

The EPA for the second quarter of 2012 will be published on 27th July; in view of the administrative records of the same period, we expect it to show an increase in employment on the order of 52,000 (4.5% YoY), much lower than the rise of 151,000 and 83,000 in the second quarter of 2011 and 2010 respectively. Assuming a slight fall in the labour force (0.02% YoY) and an increase in unemployment of only about 6,000, the unemployment rate would remain at around 24.4%.

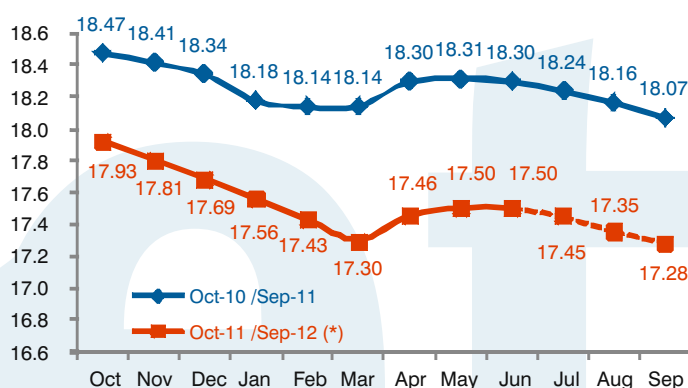
Change in EPA employment (YoY)



Source: EPA (INE) and Afi forecasts

With the end of the summer season, the number of employed will fall, as is normally the case. Our forecasts point to an even lower figure than the minimum observed in March (17.3 million).

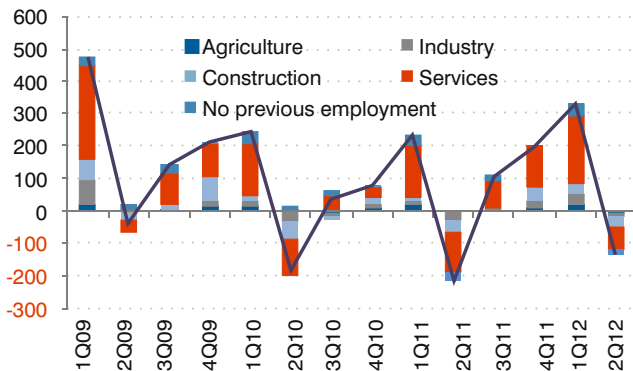
SLM monthly forecast of workers in employment (millions)



Source: Afi. (*) Jul-Sep 2012 figures are forecasts

"Unemployment decreased by 98,853, a historic reduction that will not prevent the second quarter data being much worse than those of the two previous years."

Quarterly change in unemployment by sector



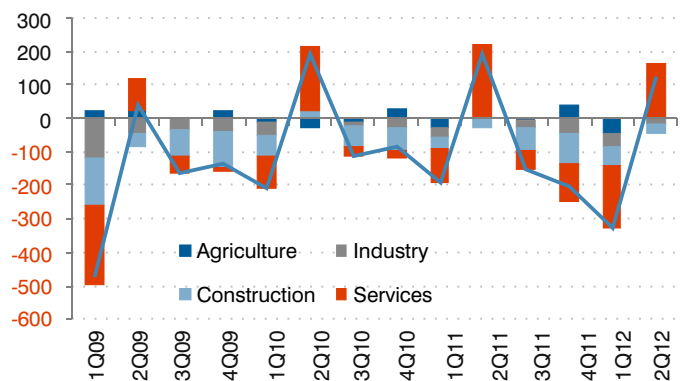
Source: Ministry of Employment and Social Security

In June there was a historic reduction in the number of registered unemployed (98,853 down on the previous month). Thus, the first half ended with 4.62 million registered unemployed, close to half a million more than in June 2011. In any case, this monthly figure is positive, as this is the fourth consecutive monthly fall in registered unemployment. Nevertheless, **the good figure for June does not prevent the second quarter being worse than the equivalent figures for 2010 and 2011.** In terms of sectors, the bulk of the fall of the registered unemployment occurred in services, though construction also experienced a significant decline. In seasonally adjusted terms, however, registered unemployment increased by 18,697, indicative of the recessionary background to the Spanish labour market

"A third of the decline in unemployment is reflected in the increase in enrolment. The hotels and catering sector and the regularization of domestic employees are responsible for the bulk of this increase."

The monthly increase in enrolment in June was 31,332, i.e. a third of the monthly fall of registered unemployment (to know if the rest have become inactive, we must await the publication of the 2Q12 EPA on 27th July). This increase is the best recorded in a month of June since the beginning of the current financial and economic crisis. However, without the seasonal effect, the increase in enrolment is 5,074. **By sector, hotels and catering provided the bulk of the increase** (up 29,726 on the previous month), as befits the seasonally favourable month of June, **but on this occasion the regularization of domestic employees also needs to be taken into account**; these alone represented an increase in enrolment of some 20,580 (the net balance of transfers from the old regime to the new).

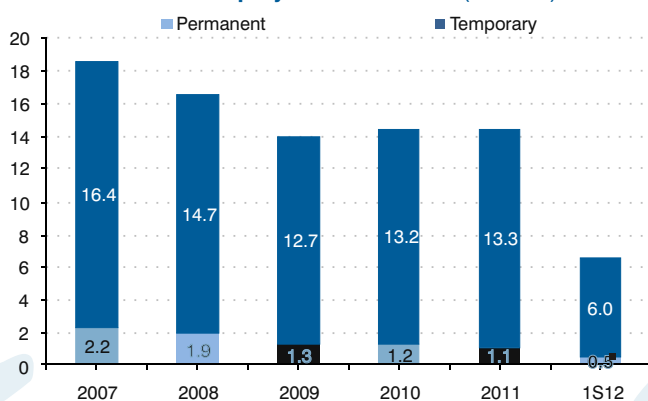
Quarterly change in Social Security enrolment by sector



Source: Ministry of Employment and Social Security

"With regard to recruitment, the number of full-time contracts declined, though there was a slight increase in the case of the permanent part-time workers. The percentage of unemployed covered by benefit continues to decline."

Total new employment contracts (millions)



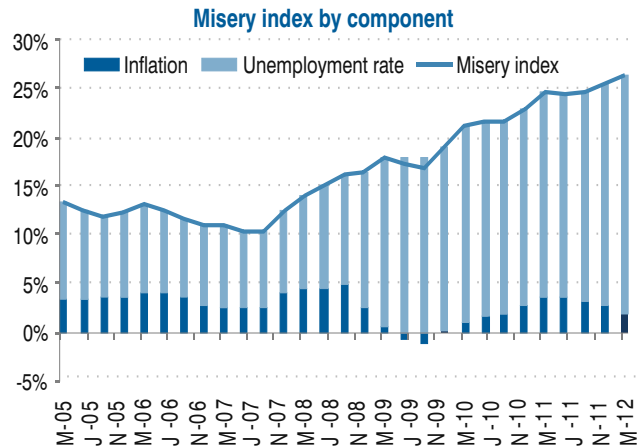
Source: Ministry of Economy and Competitiveness

In June, the number of full-time contracts declined, both permanent and temporary, with a slight increase in the number of part-time permanent contracts. Although the monthly rates of decline in recruitment in June were the lowest in the first half of the year, in general, permanent full-time hiring (two-thirds of permanent hiring) suffered disproportionately in the first half of the year. On the other hand, **the percentage of unemployed covered by benefit continues to decline.** In May, it stood at 65.4%, whereas a year ago it was about 70% (specifically, 69.3%).

"The misery index stood at 26.4% in 1Q12, 16 percentage points higher than pre-crisis levels and 1.6 percentage points higher than in 1Q11."

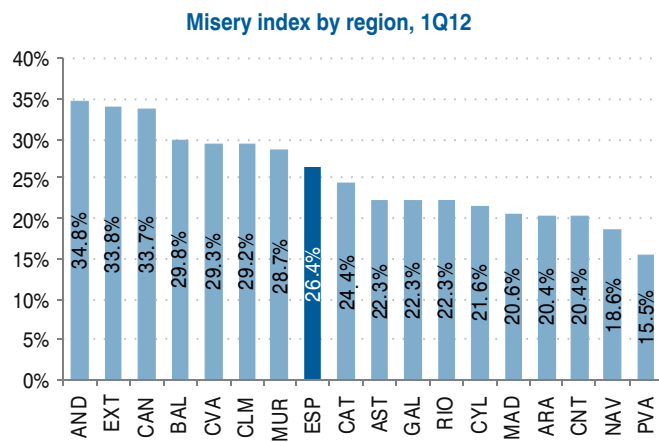
Considering the deterioration of the economic situation in the first months of the year, we think it appropriate to update the misery index which is published in this newsletter from time to time. By way of reminder, **the misery index is the sum of the rates of unemployment and inflation, providing an approximation of the impact of the crisis in terms of the living conditions in each territory.** The increases in both unemployment and prices reduce the disposable income of households; hence the sum of both effects causes a "poverty effect" which depresses the consumption and, therefore, holds back economic activity.

Since the onset of the crisis, the misery index has grown continuously, **rising from around 10% between 1Q05 and 2Q07, to 26.4% in 1Q12 (up 16 percentage points, and 1.6 pp in the last year alone).** Just as we would expect, the determining factor in the variation in the index is the deterioration in the labour market, i.e. the unemployment rate. Inflation, on the other hand, represents only 7% of the change in the first quarter of the year. This percentage is declining steadily, given that the growth of prices has been contained in the last twelve months. Rising unemployment rate and an inflation rate that has remained above 2% during 2011 and so far in 2012 is undoubtedly a combination detrimental to households' purchasing power.



Source: Afi, INE

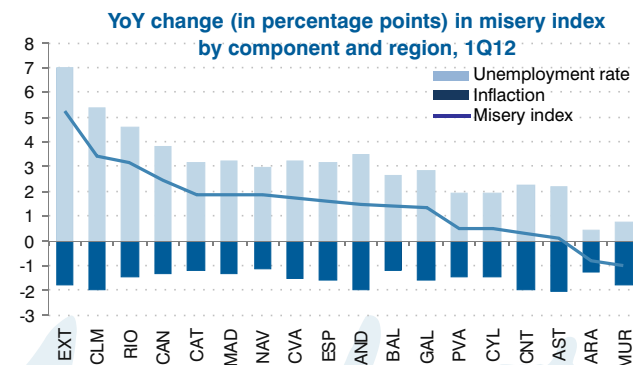
"Andalusia, Extremadura and the Canary Islands remain the Spanish regions with the highest misery index, while it was lowest in Navarre and the Basque Country in 1Q12."



Source: Afi, INE

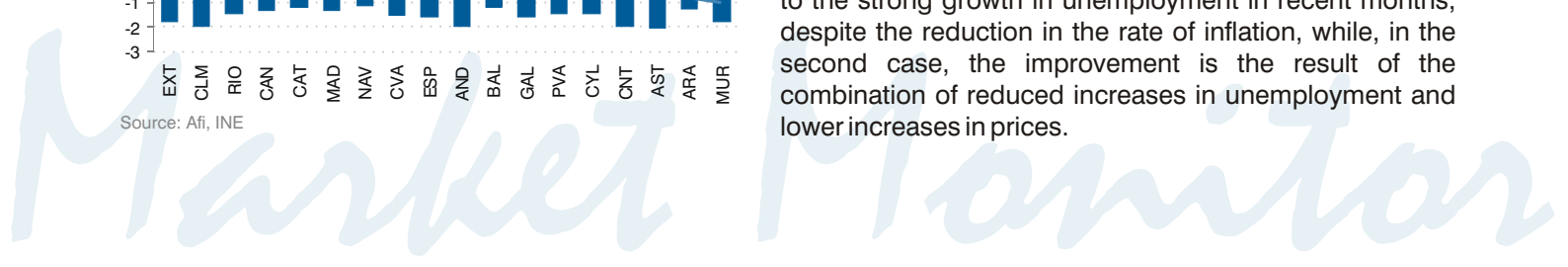
The misery index varies significantly between regions, mainly because the degree of correction in the labour market has differed, but also because of the varying levels of inflation. Thus, while **Andalusia, Extremadura and the Canary Islands remain the Spanish regions with the highest misery index** (in all three it had already exceeded 30% in the first quarter of 2012), **Navarre and the Basque Country are characterized by lower indices** (in both cases below 20% in 1Q12). There is a close relationship between the misery index and the indicators representing families' expenditure patterns. For example, in the case of retail sales, the falls in 1Q12 are greater in those regions with higher misery indices.

"The regions which have seen the greatest deterioration in the misery index are Extremadura, Castile-La Mancha and La Rioja, while those which have succeeded in reducing it are Murcia and Aragon."



Source: Afi, INE

The changes in the misery index over the past twelve months are also relevant because they show how the two parameters that most affect family finances have deteriorated. Thus, **the regions where the misery index has deteriorated most are Extremadura (5.2pp), Castile-La Mancha (3.4pp) and La Rioja (3.2 pp), while those that have succeeded in reducing it are Murcia (1.0pp) and Aragon (0.8 pp).** In the first case, the deterioration is due to the strong growth in unemployment in recent months, despite the reduction in the rate of inflation, while, in the second case, the improvement is the result of the combination of reduced increases in unemployment and lower increases in prices.

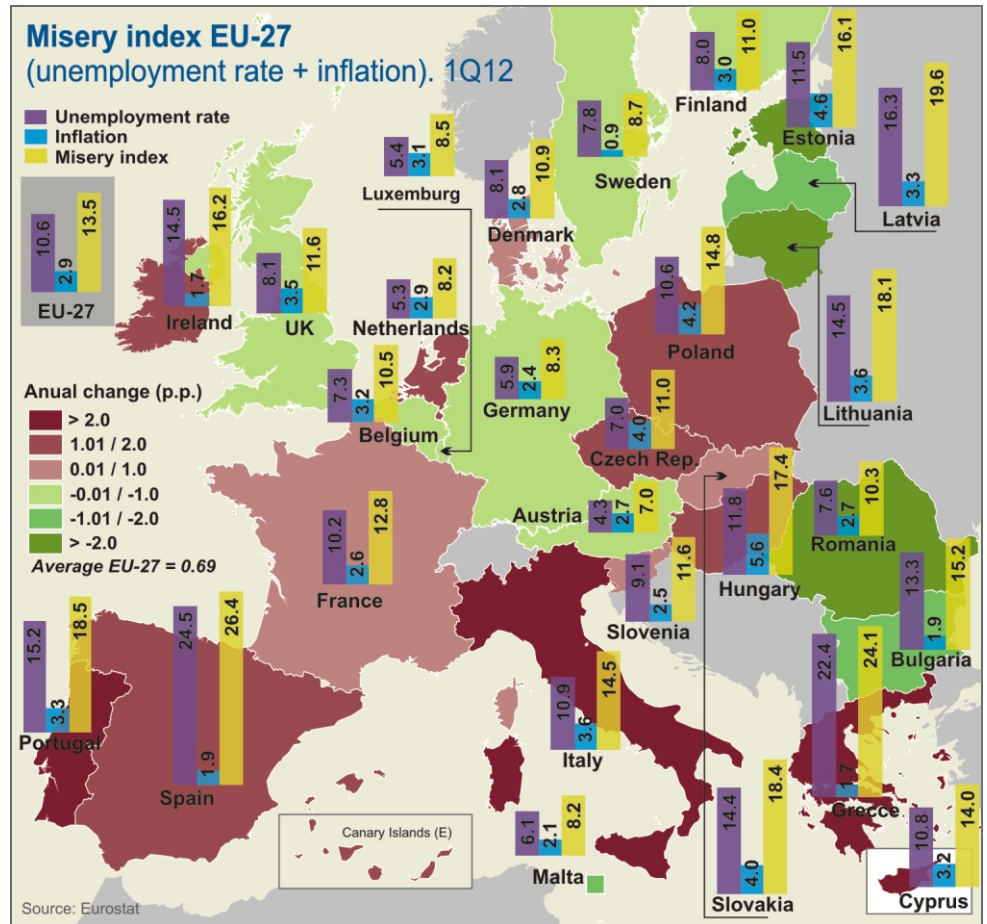


"Spain had the highest misery index of Europe in 1Q12, but it did not see the biggest increase over the previous year."

At the beginning of 2012, **Spain was the European country with the highest misery index** (over 26% in 1Q12), **but not the one where it increased most over the previous year** (1.8 pp). This variation does not exactly match the figures above because, in this case, inflation is calculated from the HICP, which is slightly different to the IPC (used for the calculation of the misery index at national and regional level).

The countries with the highest misery index in 1Q12 after Spain (26.4%) were Greece (24.1%), Latvia, Portugal, Slovakia and Lithuania, all with rates of over 18%, while the average for the EU-27 in the same period was 13.5%. It is notable that some of these countries are those currently experiencing significant economic and financial difficulties. On the other hand, Greece, Italy and Cyprus have seen the greatest deterioration in this indicator in recent months. In these countries, the misery index has increased by more than 3 percentage points, mainly due to the increases experienced in their respective rates of unemployment.

At the opposite extreme are Austria, Holland, Malta, Germany, Luxembourg and Sweden, all of which have misery indices of below 10% for the second consecutive year. Their low unemployment rate is the main explanatory factor, as their inflation is around the European average, except in the case of Sweden, where low inflation has been offset by the higher unemployment rate. Romania and Estonia, for their part, are the countries where the misery index has reduced most compared with 1Q11, registering YoY falls of more than 3.5%.



THE MONTHLY FOCUS

Escape Routes

The June registered unemployment figure raises more questions than it answers. At a quantitative level, it is good. Such a large fall has never been seen since data were first registered in 1960. However, this fall in registered unemployment occurs in conditions which leave no scope for rejoicing. The rise in enrolment was equivalent to barely a third of the decrease in registered unemployment, raising questions about what happened to those who ceased to register. Neither did recruitment increase. Retirement, discouragement, the exhaustion of benefit, emigration and the underground economy are, probably, involuntary destinations, generally less satisfactory than a return to work. We cannot let this result deceive us. Unemployment must diminish as a result of the unemployed returning to work, not because they have found ways of escaping from this situation, which end up leading them into worse situations. It is time they told us how they are going to reform the employment systems, both national and regional, and their coordination with the employment agencies, and what proactive policies will facilitate this transition.

José A. Herce, Partner, Afi.