agett Afi
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Spanish Labour Market Monitor

Presentation

The month of February has seen a further deterioration in the situation of the Spanish labour market, highlighting the difficulties of generating a sustainable economic recovery which would help reduce the number of unemployed. In fact, Spain ranks as the European country with the highest misery index in early 2011, with the gap having widened greatly in recent years due to the trend of the unemployment rate. On the other hand, there are still no clear signs that the Labour Reform passed in September is having any impact on the percentage of permanent contracts.

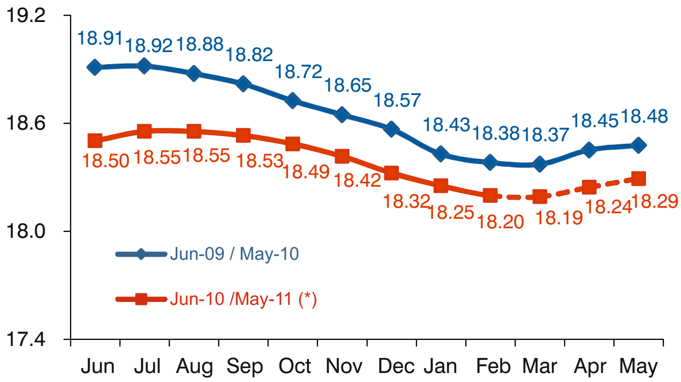
Key Points

- **The February employment data mark a break with the trend of previous months, when it appeared that deterioration in the labour market was moderating**; there was an increase of 68,000 in unemployment and a decrease of 15,000 in Social Security enrolment. The latter also saw the first setback in the moderating trend of its rate of change (to -1.3%).
- **The February drop in the number of contributors is reflected in the path of the SLM Indicator, which forecasts that employment will fall below the 18.2 million mark in March**. The impact of recruitment for the Easter holidays will allow some pickup in employment in the spring, but in May it will still not have reached the figure of 18.3 million and the YoY change in employment will continue to stagnate at around -1%.
- Neither has February been a good month for recruitment, as it declined as compared both to January and to February 2010. **The number of permanent contracts is still below 10% of the total, showing that the labour reform is still not encouraging any improvement in permanent employment**, which is one of its main objectives.
- **The misery index in Spain**, calculated as the sum of the unemployment rate plus inflation, **has increased strongly in recent years**, rising more than 10 points to stand at 22.9% in the fourth quarter of 2010.
- The change has been **particularly severe in Murcia and the Canary Islands**, where the index has increased by over 15 percentage points. Apart from these regions, Andalusia, Valencia, the Balearic Islands and Castile-La Mancha have also performed worse than the Spanish average.
- The increase in misery indices **may be attributed to the rapid rise in problems in the labour market**, while inflation, so far, has slightly mitigated the rise, contributing negatively to the index value, although its influence has been much weaker than that of the unemployment rate.
- Within Europe, Spain has the highest misery index and is where the index has increased most strongly in recent years. The difference with the EU-27 is 11.1 percentage points in January 2011. On the other hand, since September 2007 the index has shown a 13-point variation in the Spanish case, compared to an average increase for the EU-27 of 3.6 points.

The Afi-AGETT SLM Indicator

The unwelcome surprise of the February Social Security enrolment data, with an unexpected fall atypical of the trend in a normal year, served to confirm that, apart from the unfavourable seasonality typical of the start of the year, **the adjustment in employment in sectors undergoing consolidation and the lack of dynamism in many areas of domestic demand are interrupting the path of gradual improvement observed in the labour market during 2010.**

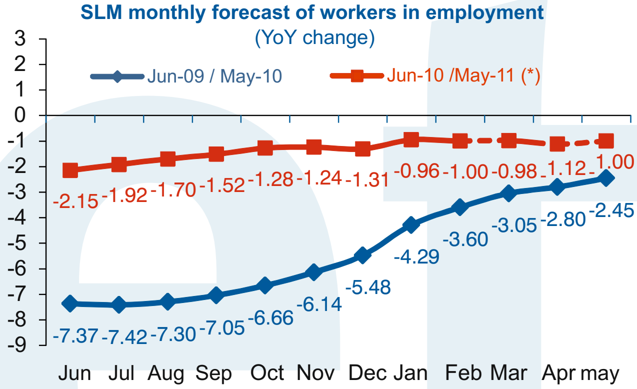
SLM monthly forecast of workers in employment
(millions)



Source: Afi. (*) Mar-May 2011 figures are forecasts

The trend in the Afi-AGETT SLM Indicator out to March reflects this relative deterioration in employment during the first months of 2011, **with further declines in the number of employed to below 18.2 million, and the stabilisation in the YoY fall at 1%.** The positive effect of Holy Week on tourism-related sectors should reverse this trend and allow a progressive recovery in employment, which should last until the summer season, offsetting the job losses of the first quarter.

SLM monthly forecast of workers in employment
(YoY change)



Source: Afi. (*) Mar-May 2011 figures are forecasts

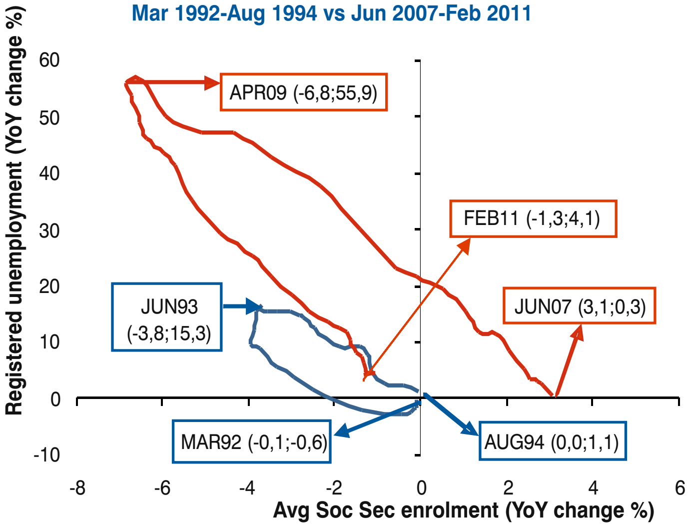
"The February employment data have turned out worse than expected, delaying once again the onset of the recovery in the labour market." "

The behaviour of the registered unemployment figures is worse than expected, even though February tends to be a poor month in employment terms. Thus, unemployment recorded an increase of 68,260, to little short of the 4.3 million mark (4,299,263), a new record.

Once again the services sector, with net job losses of almost 40,000, **is the main cause of the increase, though the other sectors also contributed**. Compared with the previous month, unemployment increased by 8,614 in agriculture, 3,559 in industry and 2,550 in construction. The number of unemployed without previous employment also continued to rise (by 13,968), meaning that the category of unemployed without recent previous experience has now reached 380,600, i.e. 206,000 more than in February 2007 (up 118%).

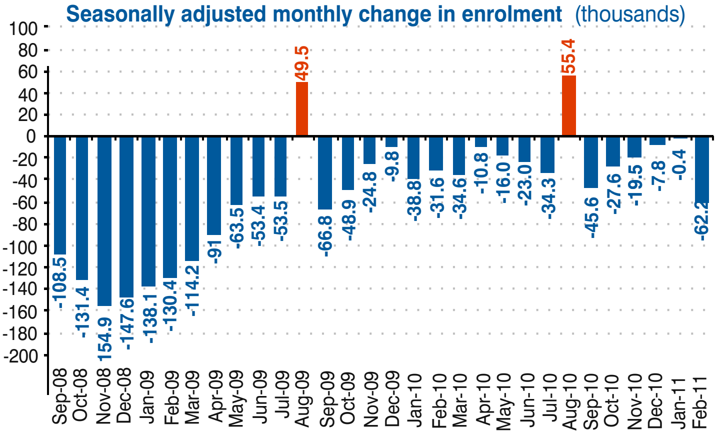
In YoY terms, registered unemployment has increased by 4.1%, or 169,000 more than in February 2010. This figure represents the **smallest YoY rise in unemployment since November 2007**.

Behavior of the Spanish labour Market in the last two recessions: Mar 1992-Aug 1994 vs Jun 2007-Feb 2011



Source: National Social Security Institute and State Employment Service

Seasonally adjusted monthly change in enrolment (thousands)



Source: Social Security

Social Security enrolment declined by 14,744 in February compared with the previous month, taking the number of contributors to 17,347,094. This is the lowest level in six years, i.e. since February 2005, a clear illustration of the scale of the deterioration in the Spanish labour market as a consequence of the crisis.

In YoY terms, the total declined by 237,888, or **1.3%.** This is 0.3 percentage points more than in January. Analysis of the labour market cycle thus indicates **a halt in the path of relative improvement** observed in previous months.

There can be no doubt that the main unknown of the current phase of economic recovery is whether it will be strong enough to allow the labour market to generate net increases in employment. For now, the employment figures signal that, once the step-like effect of the appalling 2009 data is overcome, the 2011 figures are **showing a break with the moderating trend in the labour market of recent months.**

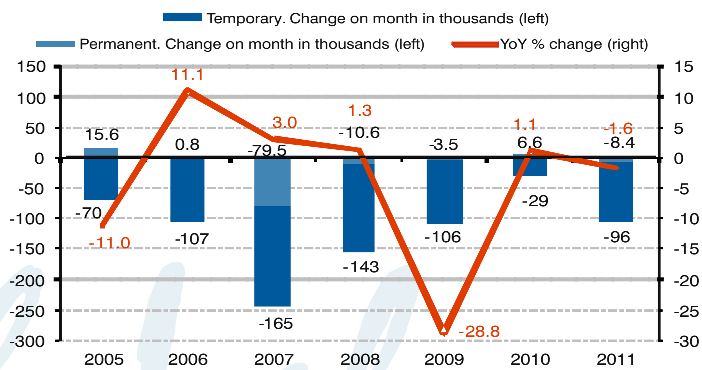
The seasonally-adjusted figures testify to this, as **the February enrolment data interrupt the progressively improving trend in the number of contributors**. The seasonally-adjusted fall in enrolment in February is the largest since September 2009.

"Hiring declined in February, both compared with the previous month and on a YoY basis …"

In a month that is usually seasonally unfavourable, the number of recruits again reduced compared to January, by more than 100,000 contracts, interrupting the improvement observed in February 2010.

Indeed, at 1,011,498 contracts, **recruitment declined by 1.6% compared with the same month last year, with the decrease in permanent contracts (6.8%) being especially significant.** The YoY fall in temporary contracts is more moderate, at 1.1%.

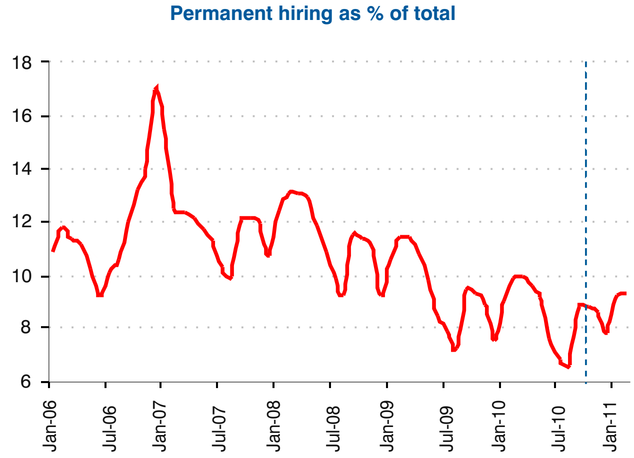
Hiring in February



Source: State Employment Service

"… while the labour market reform has yet to translate into an improvement in permanent

The percentage of permanent contracts has surged in recent months to stand at 9.3% of total contracts signed. However, although the figure is significantly higher than the minimum value to which it fell in July 2010 (6.9%), in YoY terms it is lower than in February 2009 (9.8%). This reinforces the idea that the labour reform still is not producing the positive effects expected of it in the short term. In turn, the value achieved is **still far from the percentages which were habitually observed before the onset of economic crisis** which, in general, were significantly higher than 10%.

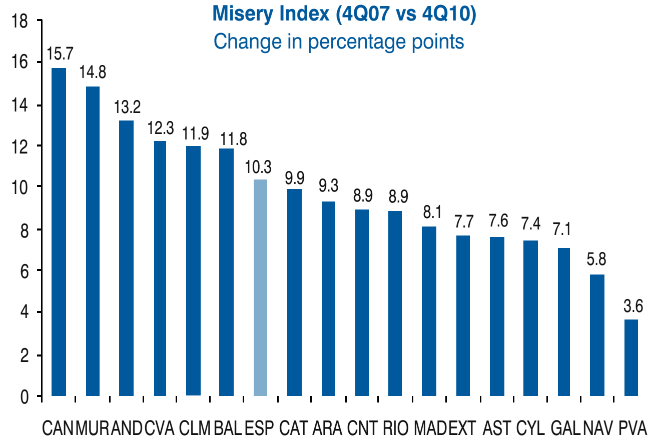


Source: State Employment Service

The Misery Index has increased by more than 10 points in Spain since the onset of the crisis …"

The misery index, the sum of the unemployment and inflation rates, is an indicator that reveals the extent of the crisis in terms of the deteriorating living standards of a territory's citizens. Higher unemployment and rising prices both cause a decrease in disposable income, so that the sum of both effects leads to a "poverty effect" that depresses consumption and economic activity slows further.

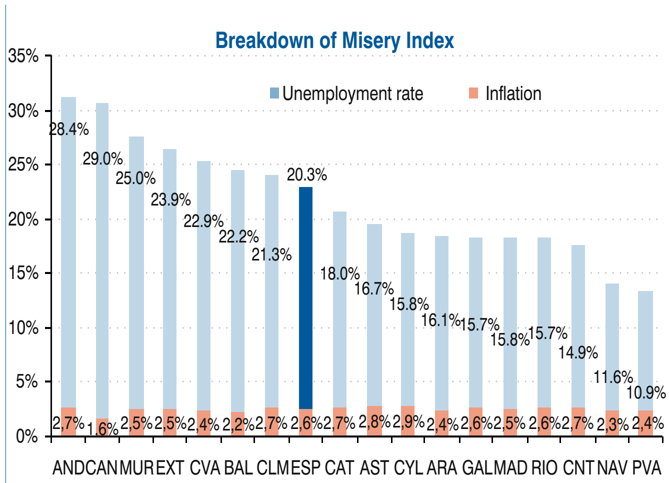
In the last three years, the misery index has risen by more than 10 percentage points in Spain as a result of the crisis, reaching a 22.9%. The Canary Islands, with an increase of 15.7 percentage points, hold the unfortunate privilege, together with Andalusia, of being the communities with the highest index in December 2010. The regions which started with higher values of the index in 2007 maintained their leading positions in 2010, as in the case of Extremadura, Andalusia and the Canary Islands. These are joined a group of regions whose negative performance in recent years has taken them above the Spanish average. These are Murcia, the Balearic Islands, Valencia and Castile-La Mancha.



Source: National Statistical Institute

"… due fundamentally to the deterioration of the labour market."

As is obvious, **the increase in the Spanish misery index is due to the strength of labour market deterioration**, since the increase in the unemployment rate has contributed nearly 12 points, while up to now inflation has alleviated this rise, subtracting just over 1 percentage point from the index. **The regions whose misery index values are above the Spanish average are characterized by their labour market problems**. In fact, the wide dispersion between regional unemployment rates, with a difference of 18 percentage points between the maximum and minimum, is the cause of the wide range between regions with high and low misery indices, as regional differences in price trends are less significant.



Source: National Statistical Institute

"Forecasts for unemployment and inflation point to further increases in the misery index in 2011."

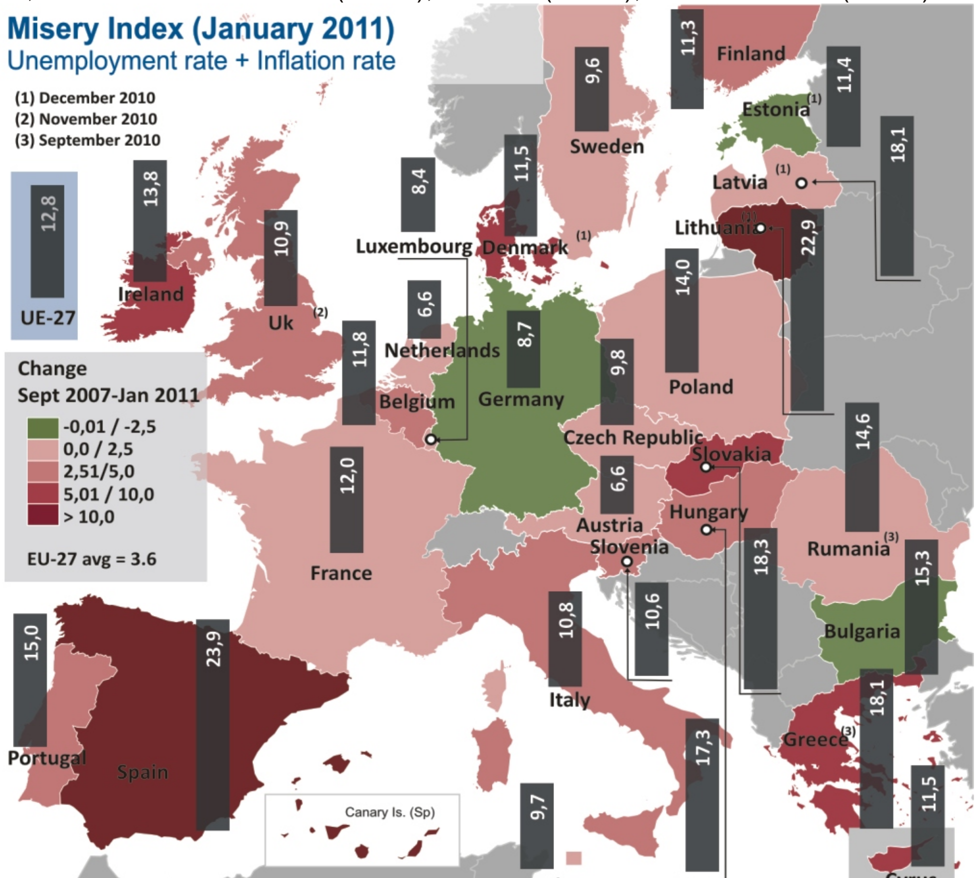
In 2011, the projected economic growth will not allow a reduction in unemployment, the annual average of which will remain slightly above 20%. Unlike recent years, **it will be inflation which is responsible for increasing the misery index**. The rise in the CPI, which in February had already risen by 3.6% on a YoY basis, shows that the Spanish economy is at risk of entering a period of stagflation, marked by economic stagnation and rising prices.

"The inefficiencies of Spain´s labour market are reflected in the fact that it has the highest misery index of any European country (23.9%)".

Spain ranks as the European country with the highest misery index (sum of the rates of unemployment and inflation), with a value of 23.9% in January 2011, **a figure 11.1 percentage points above the EU-27 average**, as reflected in data from Eurostat (in this case, based on harmonized unemployment data). The difference is shocking when Spain is compared with the countries best positioned in the standings, such as the Netherlands and Austria, both with 6.6%, i.e. more than 17 percentage points below Spain. Our country even shows a significant negative differential with those European countries suffering the effects of the current economic crisis more severely and / or which have lower income per capita, as is the case in Lithuania (22.9%), Slovakia (18.3%), Latvia or Greece (18.1%).

Breaking the misery index down into its two constituent elements, unemployment rate and CPI, we find that **the differences are mainly due to the deficiencies of the Spanish labour market.** In terms of price rises, the disparities are much smaller, with the Spanish January CPI (3.0%) at levels close to the EU-27 average (2.8%).

Spain, together with Lithuania, is **one of the countries where the index has risen most since 2007, with increases of more than ten percentage points** (13 points in the Spanish case, 12 in Lithuania), against an average increase for the EU-27 of 3.6 points. In fact, these trend data paint an even bleaker picture when compared with those observed in Germany, Estonia and Bulgaria, where the misery index has declined over the period in question.



Source: Prepared by Afi-AGETT using Eurostat data.

Moreover, t**hese differences may increase during 2011. The hesitant economic recovery in Spain will not allow sufficient job creation to bring about a fall in the unemployment rate by year end**, while most of its EU partners will see their recovery strengthen. Furthermore, **the impact of energy prices on the Spanish CPI is greater**, due to our country's high dependence on imported energy. This increase in energy prices may result, in addition, in ECB rate hikes to contain inflation in the eurozone, which could ultimately torpedo Spain's nascent economic recovery and aggravate the unemployment problem, pushing up the misery index.

THE MONTHLY FOCUS

From vertigo to fatigue

From the standpoint of employment, the worst part of the crisis was the six-month period between October 2008 and March 2009, when employment fell by almost 1.3 million. This vertiginous fall in employment triggered all the alarms and caused the unemployment rate to increase by six percentage points. In the remaining quarters of 2009, employment decreased by a further 445,000. However, in 2010 there were seasonal increases which data already published suggest will be largely offset.

The faltering data of recent months still do not signal a take-off from the floor in employment where the crisis has left us. It is now when we least need to show signs of fatigue in taking forward the labour market reforms. Let us implement as soon as possible part-time work schemes compatible with partial unemployment benefits, the generalization of German-style lay-off plans, and procedures for negotiation within companies. Let us do it by express legislation, so that the fatigue indicated by the data of these past months will not be protracted due to an inability to implement the various initiatives we have designed.

José A. Herce. Partner, Afi

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Realization and technical support: Consultores de las Administraciones Públicas (CAP)

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